Export of tax systems. Transformation of tax systems in the Third World.

The Manfred Moessner lecture delivered at the EATLP congress in Budapest, June 3, 2006, by Leif Mutén

Mr. President, dear colleagues,

I feel greatly honored by having been invited to give the first Manfred Moessner lecture and I am indeed very grateful that you invited me.

1. Why exporting our tax system?

After a spell with the International Monetary Fund 1967 as a visiting scholar I was invited to join the IMF staff as a senior advisor in the Fiscal Affairs Department. I stayed from 1968 to 1991, and much of what I have to say today is based on my experiences in that function. I am sworn to secrecy and therefore must keep what I say less specific than I would like. Yet, generalizing from experience might be better than gossipy details.

Some people asked me whether I saw my new role in the IMF as one of spreading to the world the blessings of the Swedish tax system. The question made some sense. A system that keeps the tax ratio to GDP at or near the international top without devastating the economy should be of interest to countries in need of more revenue. Yet, tax systems are delicate plants and replanting of them requires the art of an experienced gardener. And, by the way, many of us rather tend to regard the Swedish system as more of a weed than a plant.

Of course, a high tax country such as Sweden or for that matter most OECD countries might feel interested in exporting its rules to tax havens. The savings directive, the OECD work on harmful tax competition, and the EU code of conduct are all important in this connection, although perhaps not quite as watertight as their originators might wish them to be. And certainly these measures are a far cry from a uniform system.

2. Who would like to import another tax system?

The world is full of defect tax systems. In particular, developing countries and transition countries often find that their tax systems cannot match their revenue needs. Even in many industrial countries, the tax system is in need of a clean-up. The US tax reform in 1985 was followed by many other countries, Sweden in 1990. The common tendency was a broadening of the base and lowering the rates. Several countries, Sweden among them, have felt the need to modernize the legal language and give the tax code a consistent redraft. In the EU, the efforts of harmonization and approximation are certainly pursued, but at least in the direct tax field not vigorously. One must note with regret that common legislation plays second fiddle to the development of ECJ case law.

Most tax laws need refurbishing after a while. A law that might originally have stood out as simple and understandable may develop into a legal nightmare under the impression of measures taken to satisfy control needs or the interests of pressure groups. Looking for a useful pattern, it might be better to select as model a country with a new and reasonably principled code rather than one where the tax code has been eroded by legislative detail work. The world-wide triumph of the VAT would never have taken place if advisors had tried to replant the VAT code of France – the mother country of the VAT – in its incredible complication, or for that matter the sixth directive, rather than a simple system like New Zealand's.

It is a legitimate question whether a budget reform with better control of government expenditure could be a better remedy than tax reform. In countries with a tax ratio around 10 percent or less it is, however, difficult to see that saving on the expenditure side could solve the problem. This is the case even where the need for expenditure control may be obvious. With respect to expenditure many states need to be reminded that international prestige is not gained but rather lost if scarce resources are spent on conspicuous public spending. In a disturbing number of cases the meetings of African heads of state have led to bankruptcy of the host state. An alternative approach to public saving might be cutting public salaries, but the consequences in the form of corruption must be taken into account. Now back to the subject.

Tax reform in LDCs and transition countries has been necessary already in as much as independence has given the government an entirely new role. The problem, however, has often been that independence has given rise to unwarranted expectations among the public. People, who rightly or wrongly have seen their countries plundered, count on the tax burden being reduced when the revenue is not used any more to feed a colonial administration, inflicted on he country. The disappointment is great when it becomes clear that even an independent country has to face financial burdens, often greater than those of the colonial administration.

The problem is not reduced by the fact that the attitude to the tax system before independence was as negative as to see sabotage of the system as a laudable, patriotic act. It is not possible to change this attitude immediately into one of loyalty to the government and readiness to offer voluntary compliance with the taxes imposed by the new authorities. By the way, it is also a tradition, particularly in Africa, to regard water, electricity, and other utilities as a part of the human rights that citizens should not have to pay for. Utility bills might according to this tradition be looked upon with the same disgust as tax bills.

A reasonable degree of understanding of the tax system and its role in the society is a must for building up a spirit of cooperation in the public. This understanding requires public education on the tax system. It also requires a system that is regarded as just and equitable.

The fairness of the tax system is doubtful in most countries. A particularly difficult problem is that of adjusting a tax system to an LDC environment where an internationally oriented top class of enterprises and individuals exists side by side with a less advanced group of small traders and artisans and below them a class of people on the barter economy level. The first of these three sectors should pay all taxes, according to the equity concept of the two others. Yet, in some places one might still find the traditional idea that all citizens should offer some contribution, however small. Moreover, it is a widespread idea that people in the barter economy should be required to pay some tax money, since this will push them into the monetized economy and, at best, gives them an incentive to use their earnings not just to pay tax but also to purchase goods. Head taxes with this purpose were collected even long after independence. Often it was done with harsh methods: forced labor for non-payers, arrest – in a tragic case in Tanzania resulting in death by suffocation for some 30 taxpayers.

A tax system useful in such a societal structure cannot be taken directly from an industrial country. Certainly, with globalization the discussion of the effects of high taxes at home and low taxes elsewhere tends to be more than just a theoretical exercise even in rich countries. The disappearing tax base may raise doubts about the long-time prospects for the high tax systems. In LDCs, however, it is a tangible reality that big taxpayers see investment and working elsewhere as an obvious alternative. Redistribution of income and wealth might be seen, politically, as an important objective for the tax system, but if this scares away those well-to-do and their firms there will not be much left to redistribute. Therefore, even small traders and artisans must be drawn into the system, even though the approach to the administrative problems involved must differ from what applies to the top group.

3. Administrative technique

a. Qualified tax offices for big taxpayers

As long as the big money comes from the big taxpayers it is a basic experience that administrative resources with competence to keep them under control should be concentrated on them. This implies not only a realistic audit program, but also that the taxpayers should get the service from the tax authority that is needed for them to comply with the tax law.

Once upon a time there was a small office in London called OTITO (Overeseas Territories Income Tax Office) to which tax authorities in the Commonwealth could turn to get an idea about the big business operations of their foreign-based taxpayers. Regrettably, this was not compatible with anti-colonialist principles. Instead, international tax audit is now not seldom carried on by tax officers being invited to the overseas headquarters of the parent corporations on junkets that offer unreasonable temptations.

It is also part of the picture that the increasing ambitions of tax administrations in advanced countries with respect to issues such as transfer pricing pose difficult problems to administrations in LDCs. Choosing between keeping the IRS and other big power administrations happy and giving a poor country’s administration its fair share, many firms might see it as the sensible approach to get along with the more powerful tax authority.

b. Dealing with small traders and artisans

In the lower strata of taxpayers, the fundamental first-hand issue is to find out who they are. Already that question poses problems. How do you deal with a taxpayer who uses different ways of spelling his name – if the basic form is Arabic and the administrative language is one written with Latin letters, the transcription can be done in several fashions. Still, there are leading cases in commonwealth courts forbidding the tax administration to refer to a claim it has sent to the taxpayer with a “wrong” spelling of his name.

Another issue is that taxpayers try to hide and must be identified by surveying them. This is a labor intensive activity. Moreover, we must face the problem that a taxpayer may find it cheaper to offer the tax officer a modest reward for his forgetfulness rather than paying the full tax to the authority.

The size of a taxpayer’s activities may likewise be hard to estimate. A little shop towards the street may be connected with a big warehouse behind. Employees can be introduced as family members. Goods from abroad may be contraband, and customs values may be a deficient source of information.

c. The taxpayer identification number (TIN)

In Sweden we have had a complete TIN system since 1947, a 10 digit number following us from cradle to grave. That system is the best export product in our tax system, and both in bilateral assistance and through the IMF and the World Bank our system has been used.

Yet, there are problems with the TIN system. Some countries reject it as violating the integrity. That is, of course, particularly the case if the number reveals personal data. The readiness of Swedish women to reveal their age by writing their TIN on credit card slips and having it imprinted on our bank checks is rarely matched abroad. Even in Sweden, we have made an adjustment – the part of the TIN indicating the area of birth (or residence 1947) started with a 9 for immigrants until we found out that this was a great help to those who tended to discriminate against them.

A realistic case shows what might happen if there are too many cooks preparing the soup. A TIN system with 8 digits plus a control digit – in principle sufficient for a population approaching 100 million – was being installed in a country of perhaps 10 million. The eight figures lacked informative value. A new expert came in and said convincingly that birth date and gender should be part of the TIN. Accordingly, seven more digits were added making the number adequate for some ten thousand times the world population. I think this was corrected later, but the problems are many. Just think about those many who don't know when they were born. And some people after having received their TIN promptly forget it. A piece of paper with the number imprinted soon decays in a tropical climate.

d. Accounting

The old rule on the fourfold Chinese accounting system has many adherents around the world. One set of accounts (optimistic) is for the bank, another (outright gloomy) for the tax office, a third one (not too optimistic either) for the family, and the fourth one, hopefully correct, for the owner himself.

It is troubling in many places that the international auditing firms are expensive and hardly offer a realistic alternative to many local taxpayers. They are also often subject to suspicion of running the errands of the foreign firms and states. At the same time there is also a good deal of suspicion against the local firms. Training is essential here. Moreover, effective sanctions should be applied against an auditor who has failed in his duties. Yet, a tax officer eager to be on good terms with an auditing firm he might dream of joining in the future may not always be as tough as needed in his official role.

The technical opportunities to deal with subsidiaries of foreign parent corporations and with permanent establishments are, of course, limited. Some legislative proposals have been formulated making it the obligation of the parent corporation to present all its books in the country where it has a branch or a subsidiary. The answer used to be that the accounts would fill a jumbo jet, and while this is not an adequate answer in the era of computers, the country where the branch is will hardly have competent staff to deal with the material, and dealing with it would above that take disproportionate time. The reasonable solution should be exchange of information and cooperation between the revenue authorities, but again the suspicion is that the tax authority in the rich industrialized country will see to it that its interests are served in the first place.

4. Legislation

a. The structure of the law

Tax laws in developing countries normally are inspired by the old colonial power. In the British Commonwealth a model tax code from the 1920s has had wide-spread application, and in the countries belonging to the French community the tax codes have obviously been drafted by French experts. Even in the former communist countries certain legal structures are generally spread, obviously of a kind that needs great effort to be adapted so as to make them workable in a market economy.

The most seductive solution would of course be a common model for all countries affected. Two optimistic Americans, Ward M. Hussey and Donald C. Lubick, were sent to do something about the tax law in the Dominican Republic, and after having done that they felt called upon to spread the message all over the world. The book's title is "Basic World Tax Code and Commentary" and appeared the first time by Tax Analysts in 1995. It is certainly not a bad book – a kind of simplified mixture of US tax legislation.

Such a universal model is, however, doomed to fail if the ambition is its introduction everywhere. We cannot get around the fact that legislative techniques vary. If we want to change the material contents of the law, trying to change the existing formal technique is not the most practical approach. The one who has written particularly well about how this should be done is the IMF lawyer Victor Thuronyi.[1] We served once in the same central European transition country and I have a clear memory of how he started attacking his task by getting himself informed by thee Treasury people about the editorial structure of the existing laws. It might look a bit precious but the fact is that if you have not cleared out whether sections are numbered all through or chapter by chapter your proposed legal text will easily end in the waste-basket. The definition chapter is another point where traditions differ. And no mercy will be shown the expert, who presents a draft tax code in a Commonwealth country without "the charging provision" – there, the law has to be crystal clear on who should pay what tax, or else, the law is of no use. The close study of the local situation is, of course, not limited to such technicalities. One must take account of other legislation as well, family law, property law, business law, etc.

Equally important is for the tax code to be drafted with due regard to the technical conditions under which it will be applied. The amount of filling out of tax forms will differ in accordance with the frequency of illiteracy in the target group. Rules on the burden of proof, if they have to be spelled out in the statute, have to be oriented after what is practically possible – a rule telling that the tax authority has the burden of proof for all income elements and the taxpayer for the deductible items is not unusual but certainly less practical than a rule that says that the burden of proof lies on the party to whom presenting the evidence is easier.

I mentioned those British cases under which an assessment is not valid if the taxpayer's name is misspelled. That rule does not fit in everywhere.

b. Family allowances and tax progression

[1] Tax Law Design and Drafting, IMF, Washington D.C. Vol 1 1996, Vol. 2 1998.

Another rule that must be formulated with due regard to local circumstances is the one that deals with the family situation. Already the marital law may make it difficult or impossible to apply e.g. joint assessment with a splitting rule. In a country where paying out child subsidies in cash is a technically impossible task even child allowances in the income tax may be too hard a nut to crack. Very long ago the president of the Addis Ababa University told me that he had met one of the leading aristocrats of the then Empire of Ethiopia who had complained that the students had been asked for one penny more for their lunch. The president had of course responded that such a big shot could not possibly have any trouble with such a small amount but was asked back: "For how many students do you believe that I pay the lunch?" The answer, he was told, was 90.

For instance in Nairobi, Kenya, one can notice that name signs along the better roads are still there when the names are European, whereas few if any African home-owners let their names be read from the sign. The reason is said to be that these home-owners are less than enthusiastic about seeing cousins and more distant relatives lining up with a claim to economic redistribution among members of the extended family. It is not surprising that African high or middle income earners in that situation see a redistributive, progressive tax as unnecessary. At the same time, when filling out their tax returns, they may claim responsibility for a large number of dependants.

The law can hardly work with realistic family allowances and it will not be accepted as fair if a narrow limit is drawn making only the closest family members count for allowance purposes. If in this context the law will be regarded as more or less inequitable, there is good reason to ask whether any family allowance at all should be part of the law. A system like the French family quotient was originally conceived as promoting childbirth. This will not normally be a policy objective in a LDC.

There might also be good reason to think twice about a strongly progressive tax. Nowadays when "flat tax" is the recent fashion, saying that might be like kicking up an open door.

Close to 40 years ago I attended a meeting in the mighty Planning Commission of an African country. A Yugoslav UNDP expert was present, and his contribution to the debate was a proposal to increase the top marginal rate – I believe it was 70 percent – to equalize incomes. I asked him if he knew how many taxpayers were assessed to tax in this bracket. He didn't, but I had found out that the number was zero. Increasing the rate would have been an empty gesture. It would not have made a realistic assessment easier.

c. Means of enforcement

Tax audit and collection require authority and adequate means of enforcement. It begins with information returns but as I indicated before it might be hard to get these from the small trader and artisan section where arithmetic seems better spread than reading and writing. The preprinted tax returns we are nowadays spoiled with in countries with computerized tax administrations are difficult to bring about in LDCs. I might add that it is also rather imprudent, dealing with a potentially dishonest taxpayer, to let him know all that the tax office knows about him – compliance might be better if it is the taxpayer's guess how much has been reported to the tax office.

The next step is assessment. The key word is "self-assessment", something we all want practiced but that might be too much of a challenge for the taxpayers. It is also less than clear what the word means. If it implies that the information offered by the taxpayer just gets registered whereas the tax authority's deviation from them has to be motivated, the fact that a formal assessment decision is entered on the lists is more a formality – the reality is that the taxpayer has the responsibility for entering all the information needed for the assessment.

Deviations may be based on information received by the tax authority and also on legal mistakes or legally unfounded claims made in the tax return. Also, a tax audit might bring information causing a deviation from the return. Here, the system has to be realistic and pedagogic. One problem is that a tax director who cares for his social contacts may choose to send his auditors to foreigners and foreign-owned firms who may play the role of what the French call "martyrs fiscaux". The victims soon learn how to put in some rather innocent mistakes in the tax return that the auditor is welcome to find and correct. In this way, the audit shows a positive result and the danger is averted until next year.

It still rings in my ears what a colleague said when leaving for an African country where she was supposed to get the tax audit function rolling. It was with a sigh she left: "The result of my job now will be that our common friend, the director general of taxation X., will cash in twice as big bribes as before."

Realism is a key word in audit. Out in a little desert town in North Africa I found the file on a lawyer who was admitted in the court. Sure, he had been audited, but the computation of his incomes was a simple multiplication of the number of court cases he had had by the official and totally obsolete figure for reasonable fees. That this figure had nothing to do with reality was not noted, still less the luxury car the lawyer was driving. In the same country we used to take our meals in a nice restaurant where we went sufficiently often to get a picture of the probable turnover. A check with the file in the tax office showed a 70-80 percent understatement.

The power to be given to the tax authority has of course a good deal to do with protecting the taxpayer's integrity. Not least ugly are the conflicts when, like recently in Russia, the tax machinery is turned against political enemies. An arsenal of weapons for tax control put into the hands of the lackeys of power or of receivers of bribes is of course not in the right place. Still, an efficient control over the tax system is impossible without adequate means of enforcement.

Collection is not always well organized. In particular the French tradition is complicated by the observation of a constitutional principle establishing a clear distinction between assessment and collection. The effectiveness suffers when "Trésor" finds it impossible to turn to "Direction des impôts" for information on what assets a taxpayer has that could be seized for his tax debt.

A taxpayer who does not perform properly can be punished, and it is a rather common occurrence that civil penalties are meted out in normal cases, criminal proceedings being used only in the gravest ones. There are also other sanctions, such as a forced closing of the firm until the tax is paid. Of course, one might doubt the rationality of a system where the one who fails to pay his tax is deprived of his means to earn the money needed for that purpose. And as I said before, it is also impossible to support a system where taxpayers are arrested to force them to pay their tax through poorly paid, compulsory work.

d. Collection of tax in dispute

It is a matter for discussion how to look at the requirement that tax is paid in spite of the tax decision being appealed against. In my country we had for a long time an almost strict rule allowing no deferral in disputed cases, but this rule has for good reason been softened. A total softness in the form of automatic deferral would, however, sabotage the system. Frivolous appeals should not be honored. A crucial point is how a conditional deferral rule can be formulated and in particular who should decide whether to grant deferral.

A curious issue in this context with grave consequences for some taxpayers is the condition set up in some tax codes that the disputed tax has to be paid for the appeal to be heard by the court. In Latin America, for instance, the rule "solve y repete" is wide-spread. It means that one has to pay the tax in dispute for one's appeal against it to be heard, and if one cannot afford to pay, the assessment will not be changed. In the Commonwealth the rule is common that at least half of the amount in dispute must be paid for the appeal to be heard. In the US there is a similar rule but only for the taxpayer who chooses to go to the Court of Claims, not for one who goes to the US Tax Court or a regular court.

On my part I have pushed for keeping these two rules apart. Collection of taxes in dispute seems to me to be necessary to prevent frivolous appeals, and a deferral rule should be established to prevent serious damage to be caused by an erroneous assessment. With respect to the right to have appeals heard, that is a human right that should not be denied a taxpayer who – perhaps just as a result of a wrong assessment – is deprived of the means to pay an incorrect tax.

It is sad to think about what the official in charge of human rights issues at the OAS (Organization of American States) said as I raised the issue with her: "If we just had that kind of problems we would hardly be needed. The violations of human rights that the OAS has to fight against have quite another dignity."

5. Particularly on the VAT

In the old days the pun was current that newly independent countries wanted TV, TVA, and TWA, that is TV, VAT (in the French acronym), and the national airline that the new defunct airline TWA was happy to help them with. In most cases, the wish has been fulfilled.

VAT is – what few Americans have understood – a consumption tax that fulfills high neutrality standards. Regrettably, it is not quite as easy in practical application as it is in principle. Most LDCs have initially used import duties in the function of consumption taxes. The next step has been a "sales tax", partly on thee importation of consumption goods, partly on the domestic production of such goods. Such a tax has as an important advantage a very low number of taxpayers, thus simplifying the administration. There are problems, however, in separating production inputs from consumption goods, and the tax base includes neither services, nor the part of the value of consumption goods that corresponds to trade margins.

That is why by now the large majority of countries in the world have introduced a VAT. Of course, there can be doubts whether all of them have been ripe for introducing a VAT at all stages. As I some decades ago met Maurice Lauré, the Frenchman who was the inventor of the VAT (besides the German von Siemens who made his proposal thirty years earlier) I asked him about his opinion on the French measure that extended the original wholesale VAT to the retail stage. His clear response was "une bêtise", i.e. foolish. Experience has shown, however, that even a retail VAT can function reasonably well, provided the threshold for registration is set high enough to eliminate the trouble of dealing with a great number of small traders.

Another important consideration is avoiding rate differentiation with all the definition problems involved. Here tax experts are on collision course with politicians, and a one-rate VAT is a rare bird. Again, for a simple, principled VAT, look at New Zealand.

A special problem occurs when the VAT is introduced in a federal country already having consumption taxes on the province or municipal level. For Europeans it seems self-evident that the VAT should be a central government tax, and as good Europeans, we have been horrified at the poor function of the US system of state and municipal "sales taxes" and their rarely functioning appendix, the "user tax". By opening the borders in the common market, we now find ourselves facing the same dilemma. Before, we criticized the Americans for opening big loopholes by varying sales tax rates between states and municipalities and uncontrollable trade across state borders, particularly mail-order business. Now, in Europe, we have arrived at a system that is hardly more logical and consistent than the US system.

6. Capital taxes

Perhaps capital taxes should be left aside. The net wealth tax is disappearing in one country after the other, and even gift and estate taxes can occasionally be dropped, so what should we bring as our experience to the new countries? At any rate we cannot count on this kind of taxes to offer a major fiscal contribution to the budget of a normal LDC.

With respect to capital gains taxation it might seem natural to recommend a comprehensive concept of taxable income including capital gains. One problem in that context is, however, the high inflation rate in many countries. That is a strong argument for inflation adjustment of the tax that complicates its administration and reduces the potential tax base.

Another problem is that ownership of real property is not always of the same kind as in the Western world. There are African countries where virtually all land is tribal, the chiefs deciding who will till the earth or build on it. In such a context capital gains on real property never occur. If there is no stock exchange, either, capital gains taxation is a losing proposition. The outside advisor has hardly been useful, who has talked the government of such a state into legislating on capital gains tax and allocating staff for its administration.

In a nascent market economy capital taxation just as taxation of earned income raises the issue how far one can satisfy political claims for redistribution of income and wealth without putting the economic growth at risk. Once upon a time a Swedish minister of finance formulated his idea on redistributive taxation with the phrase: "Poverty is easier to accept if shared by everybody." Market economists, however, believe that poverty is more efficiently fought if a growing number of people get growingly richer, even though all cannot get rich at the same pace.

Another complication in this context is that the wealthier people in the country may be foreigners who tend to react against what they regard as unreasonable claims to tax by moving out. In the choice between scaring them away with high taxes and attracting them with low taxes it is often the latter line that prevails.

7. Direct expenditure taxation

It is a curiosity worth mentioning that the once well-known Hungarian-British economist Lord Kaldor long promoted a direct expenditure tax of the kind that professor Sven-Olof Lodin also once recommended. Lodin's famous study (SOU 1976:62) was even translated into English and Spanish. Several years later, a commission with Lodin as a member found the tax not to be an appropriate instrument with regard to the international consequences. Miraculously, Kaldor in the 1950's had succeeded in convincing the governments of India and Sri Lanka on the desirability of a direct expenditure tax. His particular objectives were those maharajas he found nonproductive while having a shockingly high standard of living. With regard to the considerable difficulties that those days met the administration of even conventional taxes in those countries, the direct expenditure tax experiment proved stillborn. I might mention that as the great Swedish economist Erik Lundberg turned 60, a scientific symposium was arranged in his honor. At the gala dinner the two famous Britons Cairncross and Kaldor gave speeches on advising LDCs, a speech Lord Kaldor if I remember correctly gave the title: "Why do they always make revolutions where I have been advising?"

These experiences remind us on the troublesome fact that competent administration is a scarce resource that should be used as productively as possible.

8. Tax conventions

The international tax issues cause big problems in LDCs. The basic issue is the lack of reciprocity. In the typical LDC capital is scarce and economic development must be financed either by foreign direct investment or by credits. One has to count on the typical situation being one where a significant outflow of payments represents interest payments and dividends, whereas there are few if any payments in this category flowing into the LDC.

It was for this reason that an expert group under UN aegis prepared a model tax convention, first published in 1980 but later revised, intended better than the OECD model to adapt to this situation of lacking reciprocity. Between industrial countries we normally give rather little attention to where the tax money lands according to a tax treaty. If we give away the tax on outflowing dividends, interest, and royalties this does not mean much more than that we get correspondingly more tax on incoming dividend, interest, and royalty payments.

Some members of the expert group, particularly Latin Americans, felt that the group by taking the OECD model as its point of departure had committed an original sin. A consistent taxation in the source country and nothing else should be the message. The Andean pact countries also prepared a model treaty along that line, the Cartagena model, but no takers outside the group were attracted. Meanwhile, the Latin American approach has largely changed. The pure territoriality principle that many of these states stuck to proved untenable by stimulating private export of capital from countries sorely needing the capital. It was maintained, for instance, that the once enormous Argentine foreign debt could easily be paid by all the money that rich Argentines had invested abroad, preferably in such countries where outgoing dividends and interest were not taxed.

It was also a question of who would actually be paying the tax if source state taxation were the norm. In my country, the traditional approach has been to assume that the cost of foreign debt is dictated by the creditor's claim for interest net after tax. This is why we have a long tradition of tax exemption for interest paid to foreign recipients. Tax on royalties does not follow a similar principle, but in principle, we want our tax treaties to impose a zero rate on outgoing royalties whereas in relations to non-treaty countries the control over royalty payments is notoriously lax.

Many countries, particularly LDCs, feel the need to tax outgoing dividends, interest and royalties, but in as much as one tends to abandon the territoriality principle the situation gets more flexible. A considerable number of Latin American states, often referring to the UN model, have now negotiated tax conventions where these countries previously had no such treaties or just a few. (Sweden has played a somewhat amusing role in his context: we have often been the first country to conclude a tax convention with a certain Latin American state, and once the treaty was concluded, the Latin American signatory turned to the US and referring to the treaty asked the Americans to offer the same concessions as Sweden granted. Needless to say, this argument has not been considered relevant.)

One point where the UN model could have been more positive concerns the “fictitious tax credit” generally being called “tax sparing” and in some forms “matching credit”. The argument for these clauses is of course that tax incentives offered by LDCs lose their effectiveness if they only mean that the creditable foreign tax is reduced and the tax minus foreign tax credit correspondingly higher in the investor’s home country. The US has traditionally refused to offer tax sparing with the argument that it is not in the interest of LDCs to offer tax incentives. The LDCs, finding this patronizing, have argued that they are themselves best placed to judge whether or not incentives make sense. The conflict on this matter has at times been rather sharp but spirits have calmed down, particularly in so far as the LDCs have found that incentives directed towards the retention of profits rather than their distribution as dividends both are in their countries’ interest and get efficient even without tax sparing. If, however, – a reform called for by many American experts – the “tax deferral” for retained profits is terminated and the US tax in accordance with a general CFC rule is levied on retained profits as well as on distributions, the tax sparing debate will most certainly flare up again.

The OECD in recent years has taken a skeptical attitude to tax sparing, and Sweden that was earlier ready to offer matching credit in all LDC treaties is now striving to renegotiate its treaties with countries that have reached a degree of development where tax sparing is no longer needed (examples are Korea and Singapore). The LDCs in turn are generally not happy to see the tax sparing clauses wither away. As a matter of fact, the enthusiasm for tax sparing sometimes goes so far that LDCs making tax treaties with other LDCs provide for reciprocal such clauses.

If in a LDC one is faced with the question whether it is worth the trouble to negotiate tax treaties, and if so, why, the answer in the first place might be that the existence of such treaties constitutes a safety guarantee, notably in two respects. First, the treaty means that the LDC declares its adherence to international usage in the tax field. Second, a treaty implies that a signatory country marks a distance against the thought of establishing itself as a tax haven and thus escapes being blacklisted as such. A LDC that demands technical assistance to establish itself as a tax haven must buy the service – official technical assistance is not available.

More doubt may be expressed with respect to CFC tax legislation and exit taxes. The risk is considerable that they are inefficient. Even treaties on exchange of information can have their negative sides. The meager administrative resources of a LDC can quickly get exhausted if industrial countries, referring to a treaty in force, request extensive information on their citizens' or firms' activities in the LDC. The information delivered might not be as valuable to the industrial country receiving it as to be worth the effort of the LDC administration.

9. Conclusions

This quick overview of the issues is, of course, rhapsodic and does not allow any firm conclusions. It should, however, be a reminder on the risks involved in international advisory activity. Above all, a good measure of modesty is in place. The international advisor with UN Laisssez-passer and a return air ticket is in a totally different situation from that of the minister of finance he offers his advice to. Ministers I have got acquainted with who have later been imprisoned and even executed are a clear reminder on this. Luckily, the end was better for the new president of Liberia, Ellen Johnson Sirleaf, who also spent some time in jail, a particular heroine of mine.

Patience is another important virtue. Perhaps it is useful to set one's expectations low and be happy and grateful if, to some extent at least, the advice is followed. Even small improvements may mean something for many people.