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Tax gaps in developing countries: Legal causes and solutions.

Tax gap
Potential tax revenue – Collected tax revenue = TAX GAP

Tax revenue to GDP ratio
OECD Countries
Developing Countries
30 - 40 %
10 - 20 %

Why should developing countries mobilize their tax revenue?

- Independence from foreign aid
- Essential for development and statebuilding

Legal causes addressed in the research

- Inefficiencies in domestic tax law
  - Fairness and efficiency
  - Procedural deficiencies
  - Lack of transparency of TA
- Tax incentives
  - Attracting foreign investors and stimulating economic growth
  - Erosion of the taxable base and race to the bottom

- Double tax treaties
  - Should developing countries conclude DTCs?
  - Source vs. Residence taxation
  - Allocation of taxing rights on passive income, capital gains and the scope of the PE provision

- Tax planning by multinationals
  - Large informal sector
  - TAs are not equipped to tackle complex tax avoidance/evasion mechanisms

- Extractive industries
  - Taxation of income from oil and mining activities
  - Revenue sharing between the investors and the source country
  - Transparent agreements between the investors and the government

Case studies

<table>
<thead>
<tr>
<th>Country</th>
<th>Geographical Location</th>
<th>DAC List of ODA Recipients</th>
<th>Tax Effort Index</th>
<th>Natural Resources</th>
<th>Tax Treaty Network</th>
</tr>
</thead>
<tbody>
<tr>
<td>Ghana</td>
<td>Africa</td>
<td>Lower middle income</td>
<td>Low</td>
<td>Yes</td>
<td>Limited</td>
</tr>
<tr>
<td>South Africa</td>
<td>Africa</td>
<td>Upper middle income</td>
<td>Medium</td>
<td>Yes</td>
<td>Extensive</td>
</tr>
<tr>
<td>Peru</td>
<td>Latin - America</td>
<td>Upper middle income</td>
<td>Low</td>
<td>Yes</td>
<td>Limited</td>
</tr>
<tr>
<td>Bangladesh</td>
<td>Asia</td>
<td>Least developed country</td>
<td>Low</td>
<td>Yes</td>
<td>Medium</td>
</tr>
</tbody>
</table>

Objective: To identify best practices and suggest common approaches

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