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Contents

1. This note discusses tax exemptions applicable to international assistance projects. The note benefits from discussions at the first global ITD[1] conference held in Rome in March 2005, and draws on work currently underway by participants in the ITD. It is intended to provide background information to the Committee of Experts on International Cooperation in Tax Matters and to stimulate further discussion. International assistance may be provided by governments, government-controlled agencies, international organisations, non-governmental organisations, and individuals. Assistance may be designed to facilitate development or reform, may respond to natural disasters or other humanitarian crises, or may advance other purposes. Because private charitable assistance raises its own set of issues, this note focuses on assistance provided by or on behalf of governments and international organisations (although some of the arguments are applicable to charitable assistance as well). Assistance may take the form of grants, may be provided in kind, or may be financed by concessional loans. The form in which the aid is provided typically does not affect the tax treatment. Exemptions for various transactions under international assistance project

20. One option for donors is to deal with each recipient country on a case-by-case basis. This provides maximum flexibility to balance the competing policy concerns. This option suffers from some drawbacks, however. Case-by-case negotiations are time consuming and can place a strain on the limited capacity of recipient countries. Absence of coordination can also lead to anomalies: donor countries will find it cheaper to operate in some countries (those offering generous tax treatment) than others, and projects financed by different donors will be subject to different regimes, not only involving administrative complexity but seemingly implying that one donor can accomplish more with a given amount of expenditure than another.

21. An alternative would be for donors and recipients to enter into discussions setting out a framework under which some exemptions for international assistance might be lifted. Such a framework could include assurances of sound public expenditure management practices in the recipient country. It could also include a review of the level of taxation and the jurisdictional rules, so as to provide assurance of reasonableness to donors.

22. The two alternatives are not mutually exclusive. Different donors may want to move at different paces (for example, the World Bank already took a decision in 2004 to largely abandon the policy of not financing taxes, but other donors have not come this far). The approach of coordinated donor discussion might also be tried in a few countries on a pilot basis.

23. In conclusion, it seems that developments on a number of fronts have rendered the policy of tax exemption for aid-financed projects obsolete at least in part. Because many different situations, types of transactions, and types of taxes are involved, there is not a simple yes-or-no answer as to whether aid-financed projects should be taxed. This seems to be a fruitful area for discussion among the concerned countries and international organisations.

Questions for discussion

24. There are a number of questions that would benefit from further discussion among donor agencies and countries that are aid recipients, including the following.

Is the use of vouchers – under which the recipient government grants no exemptions, but provides contractors with vouchers that can be used to pay the associated taxes – a desirable alternative to exemption?

28. Can the complexity of administering tax exemptions associated with aid projects be reduced by using standardised legal instruments? Can best practices be identified in terms of drafting legal instruments providing tax exemptions, under which the transactions benefiting from tax exemption and the taxes concerned would be identified with specificity?