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Tax treatment of donor-financed projects

Draft Guidelines Prepared by the Staff of the International Tax Dialogue Steering Group*

Summary

At its second session held from 30 October to 3 November 2006, the United Nations Committee of Experts on International Cooperation in Tax Matters discussed note E/C.18/2006/5 on the Tax Treatment of International Assistance Projects and, at the end of that discussion, invited the International Tax Dialogue to do further work on this issue through a process that would allow donor agencies to participate. The staff of the International Tax Dialogue Steering Group has concluded that the best way forward would be to prepare a set of draft guidelines to be discussed by the Committee and to consult with all stakeholders, including primarily donor agencies, on these guidelines.

The draft guidelines prepared by the staff of the ITD Steering group are included in this note. If the Committee agrees, the next step would be a joint meeting of donors and tax experts to discuss these guidelines. That meeting could take place in the first part of 2008. The purpose of that meeting would be to discuss the principles underlying the draft guidelines as well as their wording with a view to present to the Committee a revised set of guidelines that could subsequently be forwarded to the ECOSOC with a recommendation that these guidelines be used by donors and recipient countries when dealing with the tax treatment of donor-financed projects.

*The member organizations of the International Tax Dialogue (ITD) Steering Group are the International Monetary Fund, Inter-American Development Bank, OECD and World Bank. This note has been prepared by staff of these organizations, and represents their views alone: it should not be taken to represent the views of any of these member organizations, or of their member countries.

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I. Introduction

1. At its second meeting held on 30 October – 3 November 2006, the United Nations Committee of Experts on International Cooperation in Tax Matters discussed note E/C.18/2006/5 on the Tax Treatment of International Assistance Projects. That note had been prepared by staff of the members of the International Tax Dialogue Steering Group pursuant to the decision, at the first meeting of the Committee, that "further consideration should be given to the tax regime applied to donor-sponsored development projects with a view to making recommendations to the Economic and Social Council."

2. The note first summarized current practice in the taxation of foreign project

appropriate basis for further consultation and, ultimately, a possible recommendation to the ECOSOC.

II. Draft Guidelines on the tax treatment of donor-financed projects

INTRODUCTION

Background

8. International assistance provided by, or on behalf of, governments and international governmental organisations takes a variety of forms and serves different purposes, including the facilitation of development or reform and the response to natural disasters or other humanitarian crises.

9. In many cases, tax exemptions have been granted by recipient countries for various transactions that take place under international assistance projects. These exemptions are typically granted at the insistence of the donors and may apply to different transactions and taxes.

10. In many cases, the general tax rules would provide for an exemption without the need for a specific exemption for donor-financed projects. For example, a non-resident importing goods which will be taken out of the country after being used for a project might qualify under the terms of a general customs regime for temporary imports. A non-resident which provides services without having a permanent establishment in the country might not be subject to income tax under the general rules (many countries refrain from imposing income tax in such a situation, even where there is no double tax treaty in effect.) Or the terms of a generally applicable treaty for the avoidance of double taxation might provide for an exemption for a non-resident providing services without constituting a permanent establishment, again without specific reference to the project being aid-financed.

11. Each donor is of course free to establish the conditions under which it is willing to provide international assistance. Some donors may be concerned the imposition of taxes would decrease resources available for development activities and that it would be difficult to rally domestic support for payment of taxes. Donors should recognize, however, that tax exemptions create significant difficulties for recipient countries. Also, the Paris Declaration on Aid Effectiveness[1] reaffirmed the commitment, by various donor and recipient countries, to accelerate progress in "increasing alignment of aid with partner countries' priorities, systems and procedures and helping to strengthen their capacities". Overall, where there is sufficient confidence in governance structures and in the tax system in recipient countries, countries and international organisations providing aid should therefore be encouraged not to insist on exemption from tax for transactions relating to aid projects, unless the rules in the recipient country for taxing aid-related transactions fail to comply with internationally accepted guidelines. This is in line with the fundamental principle that underlies these Guidelines. The Guidelines are not,

1 Signed in Paris on 2 March 2005 by Ministers of developed and developing countries responsible for promoting development and the Heads of multilateral and bilateral development institutions.

however, intended as requirements. It is ultimately up to each donor, in light of its own foreign policy and other considerations, to take decisions on how to proceed.

Scope and purposes of the Guidelines

12. These Guidelines deal exclusively with the tax treatment of assistance provided by, or on behalf of, governments and international organisations. While many of the recommendations formulated in the Guidelines could possibly apply to assistance provided by NGOs, private assistance raises a distinctive set of issues and is therefore not addressed here.

13. The Guidelines incorporate a number of existing international tax standards that are reflected in multilateral instruments as well as in the network of bilateral tax treaties based on the OECD and UN Model Tax Conventions. The Guidelines recommend that the tax treatment of transactions related to donor-financed projects comply with these standards.

14. The Guidelines have been prepared for purposes of assisting donor and recipient countries in determining the appropriate tax treatment of donor-financed projects. The Guidelines should provide greater uniformity and facilitate the discussion of tax issues between donors and recipients. They should also avoid a proliferation of different rules, which would reduce transparency and increase the administrative and compliance burden of both donors and recipients.

15. The Guidelines are not binding in any way and are drafted in general terms to facilitate their understanding by non-experts. Care should therefore be taken when incorporating their principles in binding instruments. To the extent that the Guidelines reflect what is already found in the domestic laws of recipient countries or in relevant treaties (including tax treaties) concluded by these countries, there is no need to adopt them through legally binding instruments. It is recognized, however, that the existing network of tax treaties is far from comprehensive, especially as regards developing countries, and that a large number of countries are not yet parties to the multilateral instruments in the field of indirect taxes that are referred to in these Guidelines. It may therefore be quicker for countries that are aid recipients to unilaterally conform their tax laws to these Guidelines. Alternatively, a recipient country could adopt the standards reflected in these Guidelines through bilateral instruments that would be given force of law in that country.

GUIDELINES

A. General considerations

1. Donor countries, international governmental organisations and their aid agencies should not require exemptions from the taxes levied in recipient countries with respect to transactions relating to their assistance projects, unless

concerning relevant aspects of the governance structure, tax system and tax administration of recipient countries.

2. Recipient countries should ensure that their tax treatment of transactions relating to donor-financed projects is consistent with these Guidelines.

3. Officials from the Ministry of Finance or the tax administration of the recipient country should be involved in the negotiation and drafting of any provisions dealing with the tax treatment of transactions related to donor-financed projects, including where another ministry or government agency is taking the lead in the negotiations.

4. The recipient country should ensure that all legal requirements necessary to give force of law to any agreement, letter, memorandum of understanding, or other document dealing with the tax treatment of transactions related to donor-financed projects are satisfied.

5. Where tax reliefs for transactions related to donor-financed projects are granted, countries are encouraged to use mechanisms that minimise administrative burdens and reduce fraud.

B. Income taxation - employment remuneration

6. The remuneration, including employment-related benefits, for employment services related to an assistance project that an individual derives from that individual's employment by the government of the country, international governmental organization or agency thereof that finances that project should not be taxable in the recipient country if the individual

   a) is not a national of that jurisdiction, and

   b) is not a resident of that jurisdiction or became a resident solely for the purposes of rendering these services.

7. The remuneration, including employment-related benefits, that an individual derives from employment services related to an assistance project financed by a country, international governmental organization or agency thereof should not be taxable in the recipient country if all the following conditions are met:

   a) the individual is not a resident of the recipient country,

   b) during the project, the individual is not present in the recipient country for a period or periods exceeding in the aggregate 183 days in any twelve month period beginning or ending in the relevant tax year;

   c) the remuneration is paid by, or on behalf of, an employer who is not a resident of the recipient country and is not borne by a permanent establishment which the employer has in that country.

C. Income taxation - profits and payments to foreign enterprises

8. Payments made to an enterprise that is not a resident of the recipient country in connection with a project funded by a country, international governmental organization or agency thereof, as well as profits derived by that enterprise from activities exercised in connection with a project funded by that country, organization or agency, should not be subject to any income or profit tax in the recipient country unless such payments or profits are attributable to activities carried on in the recipient country during a period or periods exceeding in the

aggregate 183 days in any twelve month period beginning or ending in the relevant tax year.

9. Any specific exemption from income or profit tax granted with respect to activities of enterprises that carry on activities in connection with a donor-financed project:

   a) should not be available to enterprises that are residents of the recipient country, and

   b) should be designed in a way that does not result in an unintended exemption of a foreign enterprise in its State of residence.

D. Indirect taxation - humanitarian crises

10. No indirect taxes, including custom duties, should be imposed on the import of goods to be used to respond to humanitarian crises such as natural disasters, famine, or health emergencies. For that purpose, countries should implement the rules of, or become parties to,

   a) Chapter 5 on Relief Consignments, Specific Annex J to the International Convention on the simplification and harmonization of Customs procedures, as amended (commonly referred to as “the Revised Kyoto Convention”), and

   b) Annex 9.B. concerning goods imported for humanitarian purposes, to the

with respect to procedural aspects and the imposition of duties, taxes, interest and penalties in case of disposal or diversion of temporary admission goods.

G. Indirect Taxes – specific exemptions related to donor-financed projects

15. Where it is considered that tax relief from indirect taxes, including custom duties, must be granted with respect to goods used or supplied in relation to an assistance project of a country, international governmental organization or agency thereof in cases other than those described in the above Guidelines,

    a) the relief should be

        i) restricted to clearly identified goods that are strictly necessary for the purposes of the project, and

        ii) in the case of goods to be acquired specifically for that project, restricted to goods that are not available in the recipient country; and

    b) the taxes covered by the relief should be clearly identified, using where possible the tax terminology of the recipient country.

16. Where such relief from indirect taxes, including custom duties, is granted with respect to goods and services used in relation to an assistance project of a country, international governmental organization or agency thereof, that relief should be granted through a reimbursement or voucher method rather than through a direct exemption. The tax administration of the recipient country 3iional2so adopt procedures to ensure that goods and services on which indirect tax will be relieved are used for the purpose of the relevant project.

17. Any agreement concerning such relief from indirect taxes, including custom duties, with respect to goods used in relation to an assistance project of a country, international governmental organization or agency thereof should stipulate that when the relevant goods are disposed of in the recipient country or otherwise diverted from their intended purpose, the indirect taxes become payable on these goods under the provisions in force in the recipient country.

EXPLANATIONS OF THE GUIDELINES

A. General considerations

1. Donor countries, international governmental organisations and their aid agencies 3iionanot require exemptions from the taxes levied in recipient countries with respect to transactions relating to their assistance projects, unless

a) serious deficiencies in the governance structure, tax system or tax administration of a recipient country justify otherwise; or

b) the tax rules in the recipient country that wiionalpply to these transactions areanot consistent with these Guidelines.

For that purpose, these countries, international organisations and agencies shouonaengage in dialogue with each other and with recipient countries, concerning relevant aspects of the governance structure, tax ystem and tax administration of recipient countries.

1. Donors have traditionally been reluctant to agree to the recipient country's imposition of taxes in connection with the international assistance that they provide. This might be because they consider that the effectiveness of the funds that they allocate to foreign aid will be greater if no part of these funds is diverted towards general budgetary support of the recipient country. It might also be, in some cases, that donors may actively oppose providing any aid to the government that can be used directly for general budgetary purposes as they do not support certain expenditures financed by the regular budget. For example, the donor may be responding to a humanitarian crisis and providing support directly to refugees, but may wish to provide no support to the government. Such an unwillingness to provide general budgetary support to the recipient may arise from any number of foreign policy reasons, or might relate, for example, to a judgment by the donor that the recipient's public expenditure management framework is so flawed (e.g., involving substantial corruption) that direct budgetary support runs the risk of being largely wasted or diverted. Another possible reason for a reluctance to finance taxes in the recipient country is a concern that the recipient's tax policy is unreasonable in some way, e.g. as regards rates of taxation, which may be unusually high; as regards the determination of the tax base, which could be different from usual standards applicable to such taxes; or as regards some discriminatory feature of the tax.

2. These reasons, however, must be evaluated against the needs and the particular circumstances of recipient countries.

3. Concerns that a donor may have about public expenditure management in the recipient country may be warranted in some countries. However, a number of recipient countries have made substantial progress in this area. This suggests that, to the extent that the main concern of a donor is weak public expenditure management (e.g. a donor may feel that any direct budgetary support through the payment of taxes would be vulnerable to corruption and mismanagement), this concern can be addressed on a case-by-case basis by reviewing the situation in the particular countries where the donor is delivering aid. A review of the public expenditure management framework could convince donors, in relation to certain recipients, that this concern has been satisfied. Such a review could take advantage of the public expenditure management initiatives currently under way in a number of countries, with the participation of the IMF, World Bank, and other agencies.

4. Budget support has become an increasingly important part of 0.0176 Tvie ramewor0n mexpws 0.1278 Tw (

10. Fourth, tax exemptions can cause economic distortions detrimental to domestic production in recipient countries. If, for example, imported goods to be used for a donor-financed project are exempt, but no exemption is available for domestic purchases, then there will be a distortion in favor of imports.

11. Fifth, depending on how they are structured, tax exemptions can result in substantial transaction costs. Because policies on seeking tax exemptions may differ from donor to donor, officials in recipient countries need to familiarise themselves with the various requirements, which can be confusing and complex, particularly if tax administration is weak. Since these policies are superimposed on an existing legal framework, new legal issues may be presented (for example, whether a particular charge constitutes a "tax" which is eligible for exemption, or is instead a fee or user charge which is not eligible for exemption). In the case of VAT, exemptions tend not to work well, since they require the complex allocation of input credits (this would not be required if the exemption took the form of zero rating, but then the problem would be the creation of VAT refund claims on the part of suppliers, which places a strain on weak tax administrations). There will also be substantial costs in terms of administrative overhead (legal, monitoring and budgetary) on the part of the donor (the donor's budget rules may prohibit financing of taxes, which will require checking reimbursable expenses to see whether they include taxes; agreements need to be drafted and contracts reviewed). Where problems arise, human resources have to be devoted to dealing with them. In other words, the requirement to operate a special regime, as compared with the generally applicable tax regime, makes the contracts in question more expensive to administer.

12. Finally, granting tax exemptions to any market participants always runs the risk of creating pressures for further exemptions, whether directly as a means of alleviating competitive distortions that the initial exemption created or indirectly by creating a precedent that others can call on. Many recipient countries already find it hard to resist the pressure to grant specific tax exemptions when prospective private sector investors ask for such exemptions as an encouragement to invest on their territory. Many donors have actually urged developing countries to cut back on exemptions in their wider tax systems. This does not sit comfortably with continuing to press for exemptions for donor-financed projects.

13. These difficulties that tax exemptions pose for recipient countries often undermine the development objectives that the aid itself is intended to serve. And any scaling up of aid will amplify these difficulties.

14. These difficulties combined with the improvement of tax systems in recipient countries and a greater recognition of the need for general budget support in recipient countries have led to a growing acceptance of the principle that the general rules of taxation should apply to aid-financed projects. For instance, in April 2004, the World Bank changed its policy to allow financing of reasonable, non-discriminatory tax costs.2 Going forward, therefore, recipient countries will not have to face the choice of providing exemptions for Bank-financed projects, where

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2 See BP [Bank Procedure] 6.00 (April 2004); OP 6 ("The Bank may finance the reasonable costs of taxes and duties associated with project expenditures"). Previously, the policy of the World Bank had been that it would not use its loans to finance taxes. Recipient countries therefore had a choice. They could provide exemption for goods and services procured under Bank-financed projects or they could provide budgetary funds to pay for the portion of the project costs representing tax.

their taxation system has been determined to be a reasonable one for purposes of this policy. The determination by the World Bank as to which taxes are treated as costs that can be financed by loans is made on a country-by-country basis as part of the Bank's overall country assistance strategy. Thus far, experience with applying the policy shows that in only very limited cases are taxes found to be unreasonable and therefore ineligible for Bank financing. The net result is that virtually all taxes have been considered as eligible for fi

judgment of each donor concerned. Duplication of effort can, however, be minimized if both donors and recipients share information. For example, the analysis carried out by World Bank staff is reflected in "country financing parameters" which are supported by "country notes".[4] If these (together with similar exercises, if any, carried out by other donors) are shared among donors, together with any responses that the authorities wished to make in the case of taxes considered unreasonable, then all could benefit from the analysis carried out. The intention would not be to pass a judgement on the wider quality of a country's tax system but simply to make it easier for donors to conclude that taxes in a particular country are (or are not) broadly in line with normal international practice, and hence create some presumption that they should be allowed to apply to aid projects. In practice, therefore — and as is to some degree already the case in relation to public expenditure management systems — donors could rely on reviews carried out by others, to the extent that those reviews are supported by credible documentation and analysis.

19. If, despite the above considerations, the donor simply is unwilling to provide general budgetary support through the payment of taxes, the recipient country may have little choice than to accept the granting of tax exemptions. In such a case, however, it will still be important to take account of the procedural and administrative concerns reflected in these Guidelines.

2. Recipient countries should ensure that their tax treatment of transactions relating to donor-financed projects is consistent with these Guidelines.

country. There is no guarantee, however, that officials representing the tax authorities of that country will be consulted.

23. Given the technicality of tax legislation, the special rules that might apply to the adoption of such legislation and the need to take account of administrative tax concerns, it is important that officials representing the tax authorities of a recipient country be involved in the negotiation and drafting of any specific tax provision dealing with donor-financed projects even if another ministry or government agency is taking the lead in the negotiations.

24. Whether these officials should come from the Ministry of Finance, from the tax administration of the recipient country or from both is a matter that should be decided by that country taking into account the various responsibilities that have been granted to its tax administration. The officials that should be involved are

- Making sure that the exemption is provided by law or, if provided under agreements, that the agreements are authorized by law;
- Identifying with specificity the transactions benefiting from exemption, the applicable taxes, and the conditions for benefiting from exemption.

28. Participation of the appropriate officials from the Ministry of Finance or tax administration in the negotiation of these exemptions will often be the best way of ensuring that this is done.

29. Finally, to provide the transparency and information needed for policy making and public discussion, recipient countries should consider preparing and publishing tax expenditure analyses indicating the tax foregone as a consequence of exemptions granted with respect to foreign assistance.

5. Where tax reliefs for transactions related to donor-financed projects are granted, countries are encouraged to use mechanisms that minimise administrative burdens and reduce fraud.

30. Where it has been agreed to exempt from tax transactions related to donor-financed projects, it is important to do so in a way that minimize the burden, for the recipient country, of administering that exemption while, at the same time, minimizing the scope for tax fraud.. Guidelines 15 to 17 provide guidance as to how this may de done in the area of indirect taxes, including customs duties.

Income taxation - employment remuneration

6. The remuneration, including employment-related benefits, for employment services related to an assistance project that an individual derives from that individual's employment by the government of the country, international governmental organization or agency thereof that finances that project should not be taxable in the recipient country if the individual

a) is not a national of that jurisdiction, and

b) is not a resident of that jurisdiction or became a resident solely for the purposes of rendering these services.

treated like any employee of the States that are members of that international organization and that provide its funding.

33. Nothing in these Guidelines affect the exemptions to which various members of diplomatic missions or consular posts are entitled under the general rules of international law or under multilateral instruments such as the Vienna Convention on Diplomatic Relations and the Vienna Convention on Consular Relations. These exemptions are applicable regardless of whether or not specific exemptions are granted with respect to government employees providing services in the context of a particular donor-financed project.

34. Like paragraph 1 of Article 19 of the OECD and UN Model Tax Conventions and like the two Vienna Conventions mentioned in the previous paragraph, the Guideline provides an exception that allows a recipient country to tax the remuneration paid to local personnel who are permanent residents or nationals of that country.

7. The remuneration, including employment-related benefits, that an individual derives from employment services related to an assistance project financed by a country, international governmental organization or agency thereof should not be taxable in the recipient country if all the following conditions are met:

a) the individual is not a resident of the recipient country,

b) during the project, the individual is not present in the recipient country for a period or periods exceeding in the aggregate 183 days in any twelve month period beginning or ending in the relevant tax year;

c) the remuneration is paid by, or on behalf of, an employer who is not a resident of the recipient country and is not borne by a permanent establishment which the employer has in that country.

35. This Guideline provides for an exemption from income taxation in a recipient country in a case where a person employed by a foreign enterprise exercises his/her employment in the recipient country for a short period of time in connection with a donor-financed project. That exemption is based on a rule found in almost all bilateral tax treaties and incorporated in paragraph 2 of Article 15 of the OECD and UN Model Tax Conventions.

36. This exemption would typically apply to employees of foreign commercial enterprises that are performing work in the recipient country pursuant to contracts concluded with the donor country, organization or agency thereof. Since these individuals would not be employed directly by that country, organization or agency, they would not be entitled to the exemption referred to in Guideline 6 and should be subject to the normal taxation rules of the recipient country, subject to this exemption for short-term employment activities.

37. Since the wording of this exemption is derived from that used in tax treaties, it should be interpreted in the same way. The reference to “resident” should therefore be given the meaning that it generally has for the purposes of tax treaties and the

interpretation of the 183-day rule should be in accordance with the guidance found in the Commentary on the OECD and UN Model Tax Conventions.

Income taxation of profits and payments to foreign enterprises

8. Payments made to an enterprise that is not a resident of the recipient country in connection with a project funded by a country, international governmental organization or agency thereof, as well as profits derived by that enterprise from activities exercised in connection with a project funded by that country, organization or agency, should not be subject to any income or profit tax in the recipient country unless such payments or profits are attributable to activities carried on in the recipient country during a period or periods exceeding in the aggregate 183 days in any twelve month period beginning or ending in the relevant tax year.

38. The negative form in which this Guideline is drafted is intended to recognize that, under the existing international standards incorporated in bilateral tax treaties, income taxation of the profits of foreign enterprises should only be allowed to the extent that the profits are attributable to activities carried on in the recipient country and only as long as the enterprise maintains sufficient physical presence in that country for that purpose.

39. Indeed, bilateral tax treaties, and the UN and OECD Model Tax Conventions on which they are based, provide that foreign enterprises should only be taxable in a country on profits that are attributable to activities carried on in that country through a permanent establishment, fixed base or, in some cases, a presence of a sufficient duration (typically 6 months).

40. This Guideline is based on that approach but, given the differences of formulation and interpretation of the concepts of “permanent establishment” and “fixed base”, as well as the need to formulate a simple test that can be easily applied by the tax administrations of recipient countries, it includes a single criterion, i.e. whether the profits are attributable to activities carried on in the recipient country during a period or periods exceeding in the aggregate 183 days in any twelve month period.

41. This Guideline applies to enterprises that are not residents of the recipient country. The term “enterprise” applies to all forms of business organizations and would therefore apply to a large company as well as to an individual consultant providing services as a sole proprietorship. The Guideline is intended to cover, among other things, situations where an7177 Tc 0.21iw3e.ulate3 UN and eac

do not have ability-to-pay), and the revenue risks involved in exempting such supplies are equally small.

50. The Revised Kyoto Convention entered into force on 3 February 2006 and, as of 10 January 2007, had 52 contracting parties. However, so far only 7 countries have accepted Chapter 5 of Specific Annex J on Relief Consignments, one of which made reservations.[8] The Istanbul Convention entered into force on 27 November 1993 and, as of 1 July 2006, had 50 contracting parties. However, so far only 37 countries have accepted Annex 9 B concerning goods imported for humanitarian purposes (and one of these countries made reservations).[9]

51. This Guideline recommends that countries implement the principles of these existing international instruments as a minimum standard either by becoming a party to the relevant multilateral conventions or by unilaterally incorporating their principles in their domestic law. This would overcome the need for countries to enter into bilateral agreements to deal with humanitarian crises.

52. The following principles should be followed when designing rules and administrative practices to implement this Guideline for exempting relief consignments from import duties and taxes:[10]

– A definition of "relief consignments" should be included along the following lines:

> *goods, including vehicles and other means of transport, foodstuffs, medicaments, clothing, blankets, tents, prefabricated houses, water purifying and water storage items, or other goods of prime necessity, forwarded as aid to those affected by disaster; and*
>
> *all equipment, vehicles and other means of transport, specially trained animals, provisions, supplies, personal effects and other goods for disaster relief personnel in order to perform their duties and to support them in living and working in the territory of the disaster throughout the duration of their mission.*[11]

– Countries may find it useful to refer to the following definition of "disaster" in Article 1 of the UN Model Agreement on Customs Facilitation in International Emergency Humanitarian Assistance:

> *A serious disruption of the functioning of the society, causing widespread human, material, or environmental losses which exceed the ability of affected society to cope using only its own resources.*
>
> *The term covers all disasters irrespective of their cause (i.e. both natural and manmade).*

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8 The Revised Kyoto Convention is comprised of the Body of the Convention, of a General Annex, and of ten Specific Annexes, most of which are further divided into two or more Chapters. Countries may accede to the Convention without accepting any or all of the Specific Annexes and/or Chapters (Article 8(3) of the Convention). See http://www.wcoomd.org/ie/En/Conventions/PG0137E1.pdf for the latest status of acceptance regarding the Specific Annexes and/or Chapters.

9 Similar to the Revised Kyoto Convention, the Istanbul Convention comprises a body and 13 Annexes. Countries may accede to the Convention without accepting all Annexes, although they have to accept at least Annex A on Temporary Admission Papers and one other Annex (Article 24(4) of the Convention). See http://www.wcoomd.org/ie/En/Conventions/PG0139E1.pdf for the latest status of acceptance regarding the Annexes.

10 See Chapter 5 on Relief Consignments, Specific Annex J to the Revised Kyoto Convention.

11 Ibid.

– Accelerated and simplified clearance procedures for relief consignments should be provided[12] so that customs clearance of relief consignments is carried out as a matter of priority and simplified and expedited clearance procedures can be used, such as the lodging of a simplified, provisional or incomplete declaration, pre-arrival declarations, clearance outside normal hours and without normal charges as well as examination/sampling in exceptional circumstances only. Such clearance procedures should be provided for in the customs legislation and the necessary procedures should be planned for in advance and documented so that they can be implemented in short order.

– The exemption from duties, taxes and restrictions applicable provided for relief consignments should include[13] a waiver from economic export prohibitions or restrictions, and export duties and taxes otherwise payable; as well as a waiver from import prohibitions and restrictions, and import duties and taxes, for relief consignments received as gifts by approved organizations for use by or under the control of such organizations, or for distribution free of charge by them or under their control.

– Goods imported for humanitarian purposes, i.e. medical, surgID 6 BDts306 0 sn043 7.296 -18

– The time period for temporary admission should be determined in accordance with the needs for medical, surgical and laboratory equipment; and should be at least twelve months for relief consignments.

11. Domestically supplied goods, and services closely connected with such supplies, that would – if imported - qualify as "relief consignments" or "goods for humanitarian purposes" for import duty and tax exemption on temporary admission, should be relieved from domestic indirect taxes such as VAT, GST and other broad-based or specific sales or consumption taxes.

53. There are currently no international standards with respect to the exemption of relief consignments from domestic transfer taxes (VAT, GST, other broad-based or specific sales or consumption taxes). To avoid distortion, it would be appropriate to

addition, persons who move their place of residence to a country are often allowed to import their household goods into that country free of import and export duties and taxes, again subject to limitations as to type and quantity of the goods concerned;[15] that exemption is specifically recognized in various international instruments for diplomats, consular personnel and staff of international organisations.

56. The situation of non-resident workers dispatched to a recipient country in the context of a donor-financed project does not necessarily fall into any of these broad categories of exemptions: they are not the typical tourist travellers that are primarily targeted by the former category of exemptions, they typically do not enjoy diplomatic status, and they typically do not transfer their residence to the recipient country.

57. Bilateral assistance agreements typically provide relief from import duties and taxes for personal property of workers dispatched to the recipient country in the context of projects funded under that agreement. The following is a typical example:

> The personal property of experts charged with the execution of projects and programs in the context of this agreement and who are not citizens of [the recipient country] and do not permanently reside there, is exempt from duties, taxes and other charges when imported into [the recipient country]. When such goods are transferred in [the recipient country], the excises due must be paid in accordance with the provisions in force in [the recipient country].

58. Exempting the personal property of such workers from indirect taxes, including import duties, is justified as long as their stay is merely temporary and is related to the donor-financed project. Since there is currently no established international practice that specifically deals with import duty and tax exemption for personal effects and household goods of persons who are not travellers but at the same time do not necessarily intend to relocate their place of residence, this Guideline therefore recommended that such exemption be generally provided. This should be done subject to the following conditions:

- the scope of the exemption be defined by recourse to the internationally established notions of ‘personal effects’ and ‘removable articles’ that exist for travellers and persons relocating their place of residence;
- the type of taxes covered by the exemption be clearly defined by: using the terminology of the country which grants the exemption, and, ideally, by individually listing the country’s duties and taxes for which exemption is granted;[16]
- the beneficiaries of the exemption be o4per8prov -19.53928 dthe ees an7.28 Tm[Tm3TJ0.01655C 7U

– the application of temporary admission rules (notably the obligation to re-export within a predetermined time-period) be limited to specified high-value or high-risk goods (e.g., vehicles); and

– the other procedures and conditions be those of similar exemptions that are well-established in the domestic legislation of the recipient country.

59. Recipient countries may opt to incorporate this exemption along the lines of these recommendations into their domestic legislation, either indiscriminately for all personnel working under an assistance agreement or only for those who work under an assistance agreement that provides for this benefit "in accordance with the recipient country's domestic law provisions in force". Alternatively, such an exemption may be agreed to bilaterally.

Indirect taxes - Temporary Admission

13. No indirect taxes, including custom duties, should be imposed on the temporary admission of goods to be used for the purposes of an assistance project of a country, international governmental organization or agency thereof. For that purpose, countries should implement the rules of, or become parties to,

a) Chapter 1 on Temporary Admission, Specific Annex G to the International Convention on the simplification and harmonization of Customs procedures, as amended (commonly referred to as "the Revised Kyoto Convention"), and

b) the parts of the Istanbul Convention that relate to temporary admission.

14. For all other aspects, the general domestic rules on temporary importation should equally apply to imports carried out under such projects, in particular with respect to procedural aspects and the imposition of duties, taxes, interest and penalties in case of disposal or diversion of temporary admission goods.

60. The benefits of not imposing import duties and taxes on goods which are intended to stay only temporarily and for a particular purpose in a given country are widely recognized both by traders and by customs authorities. There are strong economic, social and cultural reasons for not imposing the import duties and taxes that would otherwise be due, for instance to allow traders to test foreign goods before they decide to import them, or to stimulate exchanges in the cultural, educational and scientific area. The customs procedure that provides for relief from import duties and taxes on goods imported for a specific purpose and on the condition that they be re-exported in the same state is commonly known as temporary admission.

61. Temporary admission plays a central role in the tax treatment of donor-financed projects, as many of the goods that are imported for the purpose of carrying out such projects are not intended to stay in the recipient country beyond the completion of the project (e.g., construction tools and equipment imported for the purpose of carrying out a construction project).

62. Most countries have provisions on temporary admission in their domestic legislation. In addition to these domestic law provisions, a number of countries have entered into bilateral assistance agreements with donor countries, international aid organizations or other donor or aid agencies which contain provisions on temporary importation. These agreements often show differences, minor or major, between them and compared to the corresponding domestic law provisions. Furthermore, by their nature, such agreements only cover activities by the contracting donor country, organization or agency, and their facilities are thus not

69. Especially for materials that can easily be diverted to the local market, such as raw materials (e.g., construction materials) and other commodities (e.g., petrol), the agreement, or an annex thereto, should determine maximum quantities; at the very least, the agreement should provide for a mechanism to determine such maximum levels in common accord and prior to the introduction of the goods into the recipient country.

70. Also, from a tax policy perspective, donors should not insist on, and recipient countries should not grant tax exemptions for goods that are identical or essentially similar to those readily available on the local market of the recipient country.

71. Moreover, the terminology used to identify the taxes for which exemption is granted is often unclear and sometimes inconsistent. The terms range from just "customs duties" over "all customs duties and taxes" and "import duties, customs duties and other taxes" to "all taxes or charges", and sometimes specifically refer to "value added taxes". Some agreements even provide exemption from import restrictions or prohibitions, whether or not limited to what would be "otherwise required for reasons of public health or safety". Certain agreements include a reference to export taxes, restrictions or prohibitions. None of the agreements surveyed defined the terms used, or contained a list of the taxes covered by the exemption. This wide variation also appeared between agreements concluded by the same donor country. In some instances, there was even inconsistency within the same agreement.

72. This lack of precision may raise questions of interpretation. When the exemption is for "customs duties" only, it may be argued that other taxes due on importation (e.g., GST/VAT, excise tax/other consumption taxes) are not exempt, whereas under a clause referring to "import duties, customs duties and other taxes" they clearly are. In the latter case, however, the question may arise whether service charges such as harbor dues, warehouse or handling charges or fees and the like are also waived, whereas there may be less doubt under a clause referring to "all taxes and charges".

73. Such issues of interpretation are compounded by the inconsistencies between the various agreements a country may have entered into, whether as a donor country or as a recipient country. Minor variations between the various agreements require constant and careful attention, in particular by the competent authorities of the recipient country, who often lack sufficient administrative capacity to do so effectively and efficiently.

74. It is therefore important that taxes covered by the exemption be clearly identified, using the tax terminology of the recipient country. Ideally, a list of the recipient country's taxes and levies for which exemption is granted will be included in the agreement itself,[20] or in an annex, with a general provision allowing the agreement to continue to apply if these taxes are modified or replaced by broadly similar taxes.

16. Where such relief from indirect taxes, including custom duties, is granted with respect to goods and services used in relation to an assistance project of a country, international governmental organization

[20] See e.g., Article 2 para. 3 ('Taxes Covered') of the OECD and UN Model Tax Conventions.

78. While this system is straightforward for import duties and taxes and for single-stage domestic sales taxes, it is more complicated for 'domestic VAT' (i.e. VAT on domestic supplies, other than import VAT). Indeed, the amount of domestic VAT for which exemption and thus treasury vouchers may be claimed is not necessarily equal to the amount of output VAT (i.e. the total consideration for the supply multiplied by the VAT rate) but is the net amount of VAT due (i.e. the output VAT minus the input VAT on domestically sourced supplies or taxed imports), the forecasting of which may prove to be more difficult.

79. Contractors under foreign-funded projects for which duty and tax exemptions are available thus have an incentive to insist on outright VAT exemption for their domestically sourced supplies, which 'break' the VAT chain and thus undermine the VAT system of input tax credits. Indeed, domestic suppliers further down the supply chain will also claim exemption, thus leading to 'exemption creep' in the VAT system.[24] Another potential weakness of the voucher system may be the risk of forgery of vouchers, although with proper controls in place this risk should not be too difficult to manage.

80. The above guideline also recognizes that whatever system is used, the tax administration of the recipient country should ensure that proper administrative procedures are applied to ensure that goods and services on which indirect tax will be relieved are used for the purpose of the relevant project. In the case of imported goods, such procedures would typically include

- Establishing a clear and strict authorization procedure to identify the importer, the type and quantity of the goods and the exempt use for which they will be imported;
- Verification upon importation, to reconcile the goods, the import declaration and supporting documents presented to customs with the prior authorization; and
- Post-clearance controls to verify whether the imported goods are put to, and are not diverted from their exempt use.

17. Any agreement concerning such relief from indirect taxes, including custom duties, with respect to goods used in relation to an assistance project of a country, international governmental organization or agency thereof should stipulate that when the relevant goods are disposed of in the recipient country or otherwise diverted from their intended purpose, the indirect taxes become payable on these goods under the provisions in force in the recipient country.

81. Most agreements providing for relief from indirect taxes with respect to goods used or provided in the context of donor-financed projects do not stipulate what happens when these goods are subsequently disposed of or diverted from their intended purpose. In most cases duties and taxes should become payable and this should be clarified in order to avoid any uncertainty.

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[24] See L. Ebril, M. Keen, J.-P. Bodin and V. Summers, *The Modern VAT*, IMF 2001, p. 89