E/C.18/2019/CRP.6

Distr.: General
5 April 2019

Original: English

Committee of Experts on International Cooperation in Tax Matters
Eighteenth session
New York, 23-26 April 2019
Item 3 (k) of the provisional agenda
Taxation of development projects

Update on the work on Guidelines on the Tax Treatment of ODA Projects

Note by the Secretariat

Summary

This note is presented FOR DISCUSSION at the meeting of the Committee to be held in New York on 23-26 April 2019.

The note includes a draft revised version of the Guidelines on the Tax Treatment of ODA Projects
that was set up at the last meeting of the Committee in order to address the issue of the tax treatment of ODA projects.

At its eighteenth session on 23-26 April 2019, the Committee is invited to have a first discussion of the attached revised Guidelines, focussing exclusively on the first three sections (Introduction, Scope of the Guidelines and Guidelines).

1. At the seventeenth session of the Committee (Geneva, 16-20 October 2018), the Co-Chair, Eric Mensah, noted that on 10 September 2018, the Committee had decided through written procedure to continue its work on the tax treatment of development projects. The Committee then decided that this work should be carried out by a new Subcommittee on the Tax Treatment of Official Development Assistance (ODA) Projects which was given the following mandate:

2. The Subcommittee met in London on 10-11-12 March 2019. During that meeting, it discussed a revised version of the 2007 Draft Guidelines on the Tax Treatment of ODA projects which were attached to note E/C.18/2018/CRP.5. That revised version took account of the annotations that were included in that note and included the written comments previously received from two Committee members.

29 November 2019: Deadline for Committee members and country observers to send written comments on the draft discussed at the October 2019 meeting of the UN Committee.

December to

GUIDELINES ON THE TAX TREATMENT OF ODA PROJECTS

TABLE OF CONTENTS

Executive summary 2

Introduction 4

Scope and purposes of the Guidelines 6

Guidelines 7

A. General considerations 7
B. Internationally-recognized tax principles applicable to ODA projects 9
a) Income taxation employment remuneration 9
b) Income taxation profits and payments to foreign enterprises 10
c) Indirect taxation humanitarian crises 10
d) Indirect taxation personal property and household goods of workers 11
e) Indirect taxation temporary admission 11

Explanations on the Guidelines 11

A. General considerations 11
B. Internationally-recognized tax principles applicable to ODA projects 24
a) Income taxation employment remuneration 24
b) Income taxation profits and payments to foreign enterprises 26
c) Indirect taxation humanitarian crises 27
d) Indirect taxation personal property and household goods of workers 32
e) Indirect taxation temporary admission 33

Executive Summary

The practice of granting tax exemptions with respect to official development assistance (ODA) projects is widespread among developing countries. A recent survey shows that such exemptions are most often provided with respect to value-added taxes, customs duties as well as corporate taxes, personal income taxes and payroll taxes, including taxes withheld at source. There are no reliable estimates of the overall tax revenues foregone through such exemptions.

The Addis Ababa Action Agenda, which includes a comprehensive set of measures aimed at addressing the challenges of financing the 2030 Sustainable Development Goals, includes a

government-to-government aid, beginning with renouncing repayments of value-added taxes

This note includes a set of Guidelines that were developed by the United Nations Committee of Experts on International Cooperation in Tax Matters in light of this commitment. The Guidelines seek to facilitate the consideration of whether or not tax exemptions should be requested with respect to ODA projects.

These Guidelines recognize that while each donor is free to establish the conditions under which it is willing to provide ODA, it should recognize that tax exemptions create significant difficulties for developing countries and run counter to the objective of strengthening domestic resource mobilization.

The Guidelines suggest that where there is sufficient confidence in governance structures and in the tax system of a developing country, donors should be encouraged to refrain from requesting exemptions from tax for transactions relating to ODA projects in that country, unless the rules in the recipient country for taxing ODA-related transactions fail to comply with internationally recognized tax principles.

The Guidelines deal exclusively with the tax treatment of projects involving development assistance provided by governments and their aid agencies, inclusing assistance provided through international governmental organizations. They incorporate a number of existing international tax principles that are reflected in multilateral instruments as well as in the network of bilateral tax treaties; they recommend that the tax treatment of transactions related to ODA projects comply with these principles.

The Guidelines are not binding in any way and are drafted in general terms to facilitate their understanding by people who have limited tax expertise. They have been prepared for purposes of assisting donors and developing countries in determining the appropriate tax treatment of ODA projects. The Guidelines should facilitate the discussion of tax issues between donors

and recipients of ODA. 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. Since many donors already follow the policy of not requesting tax exemptions for the ODA that they provide, the Guidelines should promote a greater consistency in this area.

The Guidelines first deal with general considerations relevant to the issue of whether tax exemptions should be granted with respect to ODA projects. They recommend that donors should not require exemptions except to the extent that the tax rules of a recipient country are not consistent with the internationally recognized tax principles reflected in the Guidelines or in exceptional cases where serious concerns with the payment of tax to that country result from a review of the governance structure, tax system or tax administration of that country. As a quid pro quo for the donors not requesting exemptions, the Guidelines recommend that recipient countries ensure that their tax treatment of transactions relating to ODA projects be consistent with these internationally recognized tax principles. Guidelines 11 to 18 describe these principles in relation to the following:

Income taxation employment remuneration

Income taxation profits and payments to foreign enterprises

Indirect taxation humanitarian crises

Indirect taxation personal property and household goods of workers

Indirect taxation temporary admission

The Guidelines also address the situations where specific exemptions are requested for ODA projects. In that case, the Guidelines recommend that officials from the Ministry of Finance or the tax administration of the recipient country should be involved in the negotiation and drafting of thes

INTRODUCTION

1. The *Addis Ababa Action Agenda*, [1] which was endorsed by the UN General Assembly in its 2015,[2] includes a comprehensive set of concrete actions in order to address the challenges of financing and creating an enabling environment for the achievement of the 2030 Sustainable Development Goals. One of these actions deals with tax exemptions related to government-to-government assistance:

> We will also consider not requesting tax exemptions on goods and services delivered as government-to-government aid, beginning with renouncing repayments of value-added taxes and import levies.[3]

2. The Guidelines included in this note were developed by the United Nations Committee of Experts on International Cooperation in Tax Matters in order to facilitate the consideration of whether or not tax exemptions should be requested with respect to international assistance projects.

3. International assistance may be provided to a country by foreign governments, government-controlled agencies, international organizations, non-governmental organizations (NGOs), companies or individuals. Such assistance may be designed to facilitate development or reform, may respond to natural disasters or other humanitarian crises, may take the form of peacekeeping operations, or may advance other development or welfare purposes. It may take different forms, such as grants, concessional loans and goods or services provided in kind. It may result from bilateral or multilateral assistance projects. These Guidelines, however, apply exclusively to international assistance that is provided to a country or jurisdiction by the government of a foreign country (or its subdivisions or agencies) either directly or through a multilateral development institution. This corresponds to the concept of official development assistance (ODA),[4] which is the term generally used in these Guidelines.

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1 United Nations, *Addis Ababa Action Agenda of the Third International Conference on Financing for Development (Addis Ababa Action Agenda)*

4. Tax[5] exemptions for various transactions under ODA projects are granted by many developing countries, typically at the insistence of donors. These exemptions apply in situations such as the following:

Goods are imported by a non-resident on a temporary basis (possible exemption from customs

The survey also indicates that in most countries, there are no published estimates of the tax revenues foregone through these exemptions.[9]

6. The tax rules applicable in developing countries will often provide for an exemptio

apply to international assistance provided directly by NGOs, private assistance raises a distinctive set of issues and is therefore not addressed in these Guidelines. Also, to the extent that a project involves public and private funding, the Guidelines only apply to the extent that the public funding constitutes ODA.

11. The Guidelines incorporate a number of existi

b) Income taxation profits and payments to foreign enterprises

16. These reasons, however, must be reviewed in light of global efforts to strengthen domestic resource mobilization and, in particular, of the commitment, included in the Addis Aba consider not requesting tax exemptions on goods and services delivered as government-to-government[11].

17. 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 to which the donor is providing ODA. A review of the public expenditure management framework and an assessment of the performance of a tax administration of a recipient country could convince donors that this concern has been satisfied. Such a review could take advantage of the initiatives currently under way in a number of countries with the participation of the IMF, World Bank and other agencies.

18. Support for domestic resource mobilization efforts has become an increasingly important part of overall ODA over recent years. This increased willingness to provide support for increasing tax revenues points to a potential incoherence in simultaneously insisting on tax exemptions. It is hard to find a convincing rationale for a donor who would provide financial support for domestic resource mobilization while simultaneously insisting on tax exemptions, since the same mix of support can be provided without any exemptions by reducing the level of financial support.

19. The substantial changes that have been made to the tax systems of developing countries in recent years must also be taken into account. As a general matter, the level of tax rates has come down. Income tax rates in virtually all developing countries are much lower than they were, say, 30 years ago. Likewise, tariffs have been reduced or eliminated. As far as the assertion of tax jurisdiction is concerned, many developing countries have unilaterally retrenched their taxing jurisdiction to what would be typically be permitted under bilateral tax treaties. To the extent that a concern may remain about the tax system of a recipient country, the remedy might lie not in total exemption from tax of activities financed by ODA but a more limited exemption as would be called for under generally-recognized international tax principles.

20. Moreover, the problems that the administration of tax exemptions for ODA projects create for recipient countries should be taken into account.

21. First, given the weakness of tax and customs administrations in many countries that are recipients of ODA, fraud is always a concern where tax exemptions are made available. Where tax or customs exemptions are granted, there is a substantial possibility of abuse of such exemptions. The abuse is likely to be more serious for indirect taxes. In the case of direct taxes,

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11 See paragraph 1.

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

other countries, such as the United Kingdom, Norway, the Netherlands and Belgium, have adopted a similar policy.

29. Guidelines 1 and 2 endorse that approach. They recognize, however, that in some cases, there may be valid reasons for insisting on tax exemptions despite the various developments and considerations described above. This would be the case to the extent that the tax rules of the recipient country are not consistent with the internationally recognized tax principles reflected in the Guidelines. Also, in exceptional cases, exemptions might be justified to address serious concerns with the payment of tax to a country resulting from a review of the governance structure, tax system or tax administration of that country. One example would be where the governance structure of the recipient country is such that there is a serious risk that taxes paid with respect to the ODA project would be diverted to uses that the donor would clearly

37. Given the technicality of tax legislation, the special procedural rules that might apply to the adoption of such legislation and the need to take account of administrative tax concerns, it

46. Publication of a recipient country s laws on its web site may contribute to making legal

5.1.	Guidelines 7 to 9 deal with the drafting and implementation of specific provisions for the relief from indirect taxes, including import duties, with respect to goods and services related to ODA projects.

57. This lack of precision may raise questions of interpretation. When the exemption is for

portation (e.g., GST/VAT,

excise tax/other consumption taxes) are not exempt, whereas under a clause referring to

In the latter case, however, the

checks) that are both more efficient and more trade-friendly. Experience shows that reimbursement systems can be successfully implemented, leading in some cases to an increase of government revenue.[15]

63. When implemented and administered properly, the voucher system used by some francophone African countries[16] can also be an effective method for eliminating or greatly reducing abuse and revenue loss from this type of exemption. Under this system, import duties and taxes in connection with qualifying projects are payable by way of treasury credit vouchers issued by the government. ODA public procurement bids must be submitted on a tax-inclusive basis, which thus requires the bidders to carefully plan and calculate their projects. When the contract is assigned, treasury vouchers are issued to the contractor up to the con forecasted amount of duties and taxes.[17] Any excess tax burden falls on the contractor. The system thus has a built-in control mechanism: bidders will be careful not to overstate their tax forecast to obtain the contract, while an understatement leaves the contractor to bear the excess tax burden when the contractor wins the bid. In addition, it allows the government of the recipient country to keep track of foregone amounts of duties and taxes.

64. While this system is straightforward for import duties and taxes and for single-stage domestic sales taxes, it is more compl 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.

65. Contractors under ODA projects for which duty and tax exemptions are available thus have an incentive to insist on outright VAT exemption for their domestically sourced supplies, in 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 [18] 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.

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15 E.g., Mali, cited in Customs Modernization Handbook, World Bank 2005, p. 238, box 10.9

16 See e.g. for Guinea: Instruction No 196/414/PM/MBRSP of 13 December 1996 on the tax treatment of government procurement: http://www.droit-afrique.com/images/textes/Guinee/Guinee%20-%20Regime%20fiscal%20marches%20publics.pdf

17 The system identifies which duties and taxes may be financed by the government through treasury vouchers, and which taxes must always be borne by the contractor. For instance, under the Guinea rules (see previous footnote) only (1) import duties and taxes on goods the ownership of which is transferred to the recipient country in the course of the project or which are incorporated into the constructions that are transferred to the recipient country, and (2) VAT on the domestic supplies under the contract are For contracts which are only partly donor-financed, vouchers are issued only in proportion to the foreign aid provided.

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

66. Guideline 8 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. Even if a list of exempted goods and their quantity is provided to the tax administration, the tax administration may find it problematic to monitor the quantity of such goods that are eligible for exemption. Fuel taxes (e.g. VAT and excise taxes on fuel) are particularly prone to abuse; while exemptions from such taxes are frequently requested, recipient countries should be particularly wary of granting such exemptions.

67. 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; [19]

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.

68. In the case of imported goods, the use of an automated customs management system, such as the ASYCUDA[20] developed by UNCTAD, will help administer any available exemptions while facilitating trade by reducing transaction time and costs.

Under most tax systems, persons that make certain payments to resident or non-resident taxpayers are required to inform tax authorities about these payments and, in some cases, to withhold tax on these payments. This is typically the case for the payment of remuneration to employees and subcontractors. Regardless of whether tax exemptions for transactions related to ODA projects are granted or whether they are themselves exempt from tax for other reasons, donor countries, 6 842s7GhET triereasons

72. 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 ODA project.

73. Like paragraph 1 of Article 19 of the UN Model and OECD Model and like the two Vienna Conventions mentioned in the previous paragraph, Guideline 11 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. That exception is intended to ensure that locally-recruited personnel (e.g. security guards hired for the duration of an ODA project) are not entitled to the same treatment as employees of a state sent to a foreign country.

74. The Guideline does not address the treatment of employees of international organizations as there is less international consensus on this issue. On the one hand, it could be argued that such employees, when providing services in relation to an ODA project, should be treated like any employee of the states that are members of that international organization and that provide the funding of that organization. On the other hand, tax treaties typically do not provide a special treatment for employees of international organizations

be entitled to the exemption referred to in Guideline 11 and should be subject to the normal

international instruments in this area are managed by the World Customs Organization (WCO).[24] They are:

Chapter 5 on Relief Consignments of the Specific Annex J to the Revised Kyoto Convention.[25] The Guidelines to which also comprise the Recommendation of the Customs Co-operation Council to expedite the forwarding of relief consignments in the event of disasters, and the UN Model Agreement on Customs Facilitation in International Emergency Humanitarian Assistance; and

Annex 9.B. (Goods imported for humanitarian purposes) to the Istanbul Convention.[26]

90. Guideline 15 recommends that countries implement the principles of these existing international instruments 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.

91. 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:[27]

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24 The WCO is the working name adopted by the Customs Co-operation Council, an intergovernmental organization established in 1952 to enhance the effectiveness and efficiency of customs administrations; see http://www.wcoomd.org/.

25 *International Convention on the simplification and harmonization of Customs procedures* (as amended), done at Kyoto on 18 May 1973, commonly refe
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/Topics/Facilitation/Instrument%20and%20Tools/Conventions/pf_revised_kyoto_conv/Instruments for the list of signatories

26 *Convention on Temporary Admission*, done at I
Similar to the Revised Kyoto Convention, the Istanbul Convention comprises a body and different 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/Topics/Facilitation/Instrument%20and%20Tools/Conventions/pf_revised_kyoto_conv/Instruments for the list of signatories.

27 See Chapter 5 on Relief Consignments of the Specific Annex J to the Revised Kyoto Convention.

28 Ibid.

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

Accelerated and simplified clearance procedures for relief consignments should be provided[29] so that customs clearance of relief consignments is carried out as a matter
of priority and simplih*nBox1 0 0 1 153.14 742.a0 g0 G[(of pr)6(iorit)-22(y)20(a)-5(nd si)-2(mpl)-3(

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92. In addition to the general recommendations regarding accelerated and simplified

97 The VAT legislation of some countries of some countries already provide that type of exemptions.[31]

103. 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.

104. Temporary admission plays a central role in the tax treatment of ODA projects, as many