1. Introduction

Most developed countries are characterized by a broad base for direct and indirect taxes with tax liability covering the vast majority of citizens and firms. Developing countries, in contrast, are confronted with social, political and administrative difficulties in establishing a sound public finance system. As a consequence, developing and emerging countries are particularly vulnerable to tax evasion and avoidance activities of individual taxpayers and corporations. This can be considered one of the primary reasons for large differences in the ability to mobilize own resources between developed and developing countries.

While tax revenues in OECD-countries amount to almost 36 per cent of gross national income in 2007, the share in selected developing regions amounts around 23% in Africa (in 2007) and 17.5% Latin America (in 2004).

Nonetheless, tax revenue has increased over time in many low-income countries. However, this development is mostly due to increased revenues from natural resource taxes, e.g. income from production sharing, royalties and corporate income tax on oil and mining companies and cannot be
interpreted
as a sign of an improved tax system or administration.

Tax systems in many developing countries are characterized by
tax structures
being not in line with international standards, by lack of tax
policy
management, low compliance levels and inappropriate capacities
in tax
administration. The difference in revenue mobilization also
stems from
economic conditions (size of the informal sector). In fact, most
developing
countries show a trend towards the prevalence of indirect
taxation. Many of
them rely to a great extent on indirect taxes such as value-
added taxes (VAT) with indirect taxes amounting for up to two-thirds of total
tax revenues.

In contrast, personal income taxes as a proportion of total
tax revenue still play
a minor role in contrast to OECD countries. And although
developing countries
still realize some of their domestic revenues through international trade taxes
and tariffs, they have declined over the last twenty years. Aside from these
structural differences in the tax systems between developing and developed
countries, it is important to recognize that tax losses that arise in the course of
tax evasion and avoidance activities do largely contribute to the poor
performance of state revenue mobilization in developing countries.

Tax evasion and avoidance are both phenomena that are probably
as old as taxation itself. Wherever and whenever authorities decide to levy taxes, individuals and firms try to avoid paying them. Though this problem has always been present, it becomes more pressing in the course of globalization as this process extends the range of opportunities to circumvent taxation while simultaneously reducing the risk of being detected.

In the last couple of years, strengthening self financing capacities of development countries has become a topic of increased concern and interest. Domestic revenue mobilization as a central issue of the international development agenda has been emphasized in both the Monterrey Consensus and the Paris Declaration on Aid Effectiveness. This is due to a number of reasons.

Firstly, the establishment of own revenue raising abilities is crucial for any state as it constitutes a prerequisite to ensure a sustainable development process and implement pro-poor policies. Since self-financing capabilities in developing countries are often not sufficient, generating tax revenue is highly relevant for many developing countries.

Secondly, fair and efficient tax systems can contribute to good governance, accountability of the state and democracy by establishing a bargaining process between the state and its citizens: Governments that rely on broad based
taxation are forced to take the demands of their taxpayers into account. At the same time, the way in which a government levies taxes essentially affects the citizen’s identification with the state and its governmental agencies, potentially increasing trust and compliance of its citizens and ultimately promoting political participation.

Thus, besides generating public revenues, strengthening tax systems in developing countries is equally important from a governance or state-building perspective. Thirdly, revenue raising systems typically include the entire population, thereby exhibiting a direct effect on the poor and their household income. Designing a tax system in a pro-poor way can e.g. be achieved by including a redistributive component. All in all, collecting a sufficient amount of revenues is essential for a country to fund pro-poor programs, build effective government institutions and strengthen democratic structures, stimulate sustainable economic growth and reach national and international development goals. To reach these goals it is, however, essential that the tax system is implemented the way it was designed. Thus, counterproductive activities like tax evasion and avoidance practices, that undermine the intentions of the system, need to be reduced.

The present study aims at developing a deeper understanding of
the problem of tax evasion and avoidance in developing countries. Against the background of growing interest by international development cooperation, governments of developing and developed countries and international institutions in this topic, this study shall contribute to the systematization of knowledge.

It becomes apparent that although there is a theoretical basis explaining tax evasion and tax avoidance behavior, we know little about the patterns and the extent of tax evasion and avoidance in the regions of the world and the different techniques used to evade and avoid paying taxes in individual developing countries.

Section 2 focuses on the terminology of tax avoidance and evasion followed by a presentation of governmental, cultural, social and legal factors that influence the (voluntary) compliance with the tax system (Section 3).

Different modes of tax evasion and avoidance are outlined in Section 4. Section 5 describes approaches and measures to combat and reduce the scope of tax evasion and avoidance activities. The last section concludes.

2.1. Terms and definitions
The subject of tax evasion and avoidance embraces many dimensions and problems. As there exists no clear-cut distinction between tax evasion and tax
avoidance, one firstly needs to define which practices can be considered as violation or abuse of tax codes. To create a level playing field when discussing these issues, the following terms and definitions are helpful.

**Tax evasion** in general refers to illegal practices to escape from taxation. To this end, taxable income, profits liable to tax or other taxable activities are concealed, the amount and/or the source of income are misrepresented, or tax reducing factors such as deductions, exemptions or credits are deliberately overstated (see Alm and Vazquez, 2001 and Chiumya, 2006). Tax evasion can occur as an isolated incident within activities that are – in other aspects – legal. Or tax evasion occurs in the informal economy where the whole activity takes place in an informal manner – this means the business is not only evading tax payments but is also not registered as formal enterprise at all.

**Tax avoidance**, in contrast, takes place within the legal context of the tax system that is individuals or firms take advantage of the tax code and exploit “loopholes”, i.e. engage in activities that are legal but run counter to the purpose of the tax law. Usually, tax avoidance encompasses special activities with the sole purpose to reduce tax liabilities. An example for tax avoidance is strategic tax planning where financial affairs are arranged such in order to
minimize tax liabilities by e.g. using tax deductions and taking advantage of tax credits.

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Dr. Elke Siehl – Director of Division State and Democracy
Dag-Hammarskjold-Weg 1-5
65760 Eschborn
T +49 61 96 79-0
F +49 61 96 79-11 15
E info@giz.de
I www.giz.de/public-finance

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