

Miranda Stewart dedicates this book to her brother, Thomas Alexander Stewart, who always strived for creative solutions.

Yariv Brauner dedicates this book to his parents, Judith and Isaac Brauner, who always seek fairness.

Tax, Law and Development

Edited by

Yariv Brauner

University of Florida, Levin College of Law, USA

Miranda Stewart

University of Melbourne Law School, Australia

Edward Elgar

Cheltenham, UK • Northampton, MA, USA

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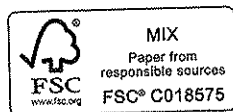
Published by
Edward Elgar Publishing Limited
The Lypiatts
15 Lansdown Road
Cheltenham
Glos GL50 2JA
UK

Edward Elgar Publishing, Inc.
William Pratt House
9 Dewey Court
Northampton
Massachusetts 01060
USA

A catalogue record for this book
is available from the British Library

Library of Congress Control Number: 2012946671

This book is available electronically in the ElgarOnline.com Law Subject
Collection, E-ISBN 978 0 85793 002 6



ISBN 978 0 85793 001 9

Typeset by Columns Design XML Ltd, Reading
Printed and bound by MPG Books Group, UK

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Contributors

Yariv Brauner, Professor of Law, University of Florida, Levin College of Law

Allison Christians, H. Heward Stikeman Chair in Tax Law, McGill University Faculty of Law

Tsilly Dagan, Professor of Law, Bar Ilan University School of Law

Ana Paula Dourado, Professor of Tax Law, Faculty of Law, University of Lisbon

Tracy Gutuza, Senior Lecturer, University of Cape Town

Anthony C. Infanti, Professor of Law and Associate Dean for Academic Affairs, University of Pittsburgh, School of Law

Charlene D. Luke, Associate Professor of Law, University of Florida, Levin College of Law

Lisa Philipps, Professor, Osgoode Hall Law School and Associate Vice-President Research, York University

Pasquale Pistone, Ad Personam Jean-Monnet Chair in European Tax Law and Policy, Vienna University of Economics and Business, and Associate Professor, University of Salerno

Luís Eduardo Schoueri, Professor of Tax Law, University of São Paulo

Miranda Stewart, Professor of Law, University of Melbourne Law School

Wei Cui, Professor of Law, China University of Political Science and Law

6. Is this a pipe? Validity of a tax reform for a developing country

Ana Paula Dourado*

I. INTRODUCTION

René Magritte's painting illustrating a pipe and entitled 'this is not a pipe' highlights the difference between the object and its representation. A tax reform in a developing country where plural legalities coexist (the object, Magritte's pipe or pipes) will induce the tax legislator to represent a unitary solution that is to be enforced by officials who may initially identify themselves with diverse legalities. The challenge for the drafter of the tax reform will be to identify the legalities in force, to grant validity to some of them, and to represent the result in a unitary tax law that will be accepted as valid by tax officials and taxpayers. The result will then be another pipe with selected elements of the underlying pipes.

Assume that the technical assistance of an external legal drafter is requested to draft and discuss with local officials, parliamentary members and publicly with other players and taxpayers, a whole or partial tax reform in a developing country. The external legal drafter is expected to play the Hercules legislator¹ in a society in transition and rich in plural legalities. Assume further that she is an expert contracted by an international organization, and in her skin as Hercules legislator she will have an excellent knowledge of the topic, both from a theoretical and a practical perspective. Our external legal drafter is an academic, and therefore has a good acquaintance with the legal system and existing tax law that is to be reformed, with the family of law to which it belongs,

* Has been acting as expert at the legal department of the IMF, drafting and negotiating the tax reforms in Portuguese-speaking countries since 2003.

¹ In analogy to Dworkin's Hercules judge: G. Dworkin, *Taking Rights Seriously* (Cambridge, MA: Harvard University Press, 1978 (1977)) 105-7; G. Dworkin, *Law's Empire*, Fontana Masterguides (Glasgow: Frank Kermode (ed.), 1986) e.g., chs V and VI.

and with many other legal systems belonging or not to the same legal family. She is open to engaging with multiple legalities, including the traditional ones, and she is aware that some of the comparable tax legislation in force in other countries is considered to be a bad example while others may be seen as a model to be followed. Beyond her theoretical knowledge, our external legal drafter has experience participating in previous tax policy definition and legal drafting at the OECD, the EU and in developing countries, and has worked for a national Ministry of Finance.

Assume also, that she acts with considerable policy independence and is engaged in taking her work on tax reforms seriously, fulfilling the role of rational draft legislator envisaged by John Stuart Mill and Enlightenment thinking.² This rational draft legislator will not be an obstacle to the aspiration that legislation should emerge from communication and disagreement in democratic assemblies that will internalize dissenting opinions³ and enact tax law according to the principle of separation of powers.⁴ In fact, it is contended here that she will be acting with a national tax reform committee to which she will present her ideas and receive adequate input. In that process, a thorough discussion will occur in respect of tax policy and the concrete legal solutions proposed. It is then expected that the tax legislation will be enacted by a deliberative assembly debating different views and that this assembly is structured with procedural rules securing a democratic decision-making: rules about representation, hearings, debates, amendments and voting.⁵ It is therefore assumed that the rule of law will be observed, at least in its formal and basic aspects, as may be observed by an external legal drafter.

This chapter aims to discuss the challenges that policy principles, legal choices and constraints pose to the perfect legislator, our Hercules legislator, in a developing country, in a globalized world, and in a market economy. This Hercules legislator will not only have to perfectly grasp

² Jeremy Waldron, *Law and Disagreement* (Oxford: Oxford University Press, 1999) 42–5, 51–5, 70–71, 97–9.

³ *Ibid.* 21–4, 27, 39–41, 66, 69 *et seq.*

⁴ Ana Paula Dourado, 'General Report, In Search of Validity in Tax Law: The Boundaries between Creation and Application in a Rule-of-Law State' in *Separation of Powers in Tax Law* (The Netherlands: EATLP, 2010) 29–33; 'The Delicate Balance: Revenue Authority Discretions and the Rule of Law – Some Thoughts in a Legal Theory and Comparative Perspective' in Chris Evans, Judith Freedman and Rick Krever (eds), *The Delicate Balance, Tax, Discretion and the Rule of Law* (IBFD, 2011) 16–19; Waldron, *supra* note 2, at 49 *et seq.*, 69 *et seq.*

⁵ Waldron, *supra* note 2, at 40.

the best technical solutions, their complexity and consequences. She will have to deal with the plural legalities in force. She will face, for example, a market economy organized according to state law, involving different sectors of activity and local and foreign investors. She will learn that foreign investors related to certain sectors of activity require tax holidays as a condition to invest in the country. She will be aware that the informal sector has a strong participation in the economy and that there are high levels of corruption, possibly involving several hierarchical levels of the state. She will learn that different communities with a diverse economic organization, concepts of family, wealth and ability to pay coexist in that state.

II. LEGAL PLURALISM

A. Legal Pluralism in the Anthropological-Sociological Sense

Legal pluralism can be described as the coexistence of two or more legal systems in the same social field.⁶ When first mentioned in the literature in the 1920s and 1930s, legal pluralism was linked to colonial societies. It was at the time realized, to a certain extent to the surprise of lawyers and anthropologists, that pre-colonial legal orders coexisted with colonial laws, and legal pluralism was understood as a result of the introduction of European colonial law.⁷ The complexity of the pre-colonial orders themselves was not questioned until recently.⁸

In S.E. Merry's article, the strictest meaning of legal pluralism is related to the situation in countries that are European ex-colonies, even though it was known that world migrations have long since led to exporting legal concepts and systems, together with the exportation of culture. In a sociological sense, legal pluralism exists in every society since each group – universities, communities, etc. – has its own set of rules, which coexist with state rules.

⁶ Alessandra Facchi, *I Diritti nell' Europa Multiculturale, Pluralismo Nomativo e Immigrazione* (4th edn, Rome/Bari: Editori Laterza, 2008) 38; Leopold Pospisil, *The Anthropology of Law: A Comparative Theory of Law* (New York: Harper and Row, 1971); John Griffiths, 'What is Legal Pluralism?' (1986) 24 *Journal of Legal Pluralism and Unofficial Law* 1; Sally Falk Moore, 'Law and Social Change: The Semi-Autonomous Social Field as an Appropriate Subject of Study' (1973) 7 *Law and Society Review* 719; Sally Engel Merry, 'Legal Pluralism' (1988) 22(5) *Law and Society Review* 870 at 869–901.

⁷ Merry, *supra* note 6, at 869.

⁸ *Ibid.* 869–70.

Even where legal theorists adopt a broad concept of law, the concept of legal pluralism used by sociologists and anthropologists tends to be broader, covering the rules adopted by every subgroup of a society, such as families, lineage, communities, factories, corporations, universities, as well as tribunals and security forces.⁹ As Griffiths has put it, there is a social science view of legal pluralism as an empirical state of affairs in society (the coexistence within a social group of legal orders that do not belong to a single 'system') and a 'juristic' view. However, contrary to Griffiths' juristic view of legal pluralism, the latter does not confine itself to state law or, in his words, to situations where 'the sovereign commands different bodies of law for different groups of population varying by ethnicity, religion, nationality, or geography, and when the parallel legal regimes are all dependent on the state legal system'.¹⁰

B. Legal Pluralism in the Strict Legal Sense: Law is Not Exclusively State Law

The aforementioned misunderstanding lies in the fact that law does not have to correspond to the Kelsenian concept characterized by a pyramid or a rigid hierarchy of rules, where the state has the monopoly in enacting or validating and recognizing them.¹¹ Moreover, legal positivism is not necessarily or even essentially statist, since custom and customary law, in the sense it is understood by legal theorists, can also comply with positivistic parameters.¹²

For example, Hart's concept of law, packaging primary and secondary rules, accommodates sources of law that do not necessarily emanate from the state, since law exists and is valid if there are commonly accepted rules of recognition.¹³ That is, law exists and is valid as long as there is a 'concordant practice by courts, officials and private persons' identifying

the validity of law according to publicly known criteria and applying it (internal statement), those criteria (rules of recognition) exist and are valid (external assessment),¹⁴ and the legal system as a whole is valid (due to the internal and the external assessment). Hart even mentions the case of pathological systems evolving from a colonial status to independency¹⁵ and in that context he foresees the case of conflicts of validity due to conflicts among different officials applying conflicting rules of recognition and a break of unity among them.¹⁶

It seems indisputable, however, that outside pathological situations, legal pluralism, including coexistence of pre-colonial with colonial legal systems and the latter with post-colonial legal systems, were not on Hart's agenda. On the one hand, Hart distinguishes between pre-legal and legal societies, where in the former there are only primary rules shared by the community, but no officials imposing them, and in the latter primary and secondary rules, namely, rules of recognition; on the other hand, Hart essentially discusses scenarios of unity of law.

In *The Concept of Law*, Hart's primary rules impose duties and his secondary rules confer powers, public or private, leading to the creation or variation of duties or obligations.¹⁷ Hart's secondary rules contain the criteria for identifying the law, and they 'specify the ways in which the primary rules may be conclusively ascertained, introduced, eliminated, varied, and the fact of their violation conclusively determined': secondary rules are classified by Hart in categories that include rules of recognition, specifying the criteria of legal validity; rules of change, empowering an individual or a body of persons to introduce new primary rules for the conduct of the life of the group, and to eliminate old rules; rules conferring private power (to conclude a contract or transfer property); and rules of adjudication (defining judges or courts, jurisdiction, and judgment), as well as rules centralizing the official sanctions of the system. A primary rule is valid if it passes all the tests by the rule of recognition, even if they conflict with other rules of the system and even if the latter are to prevail, namely, because the system contains an ultimate rule of recognition with a supreme criterion of validity.¹⁸

Such a concept of the legal system corresponds to a more complex legal system and does not describe pre-colonial societies and their

⁹ Merry, *supra* note 6, at 870; David Nelken, 'Eugen Ehrlich, Living Law, and Plural Legalities' (2008) 2 *Theoretical Inquiries in Law, Legal Pluralism, Privatization of Law and Multiculturalism* 446; Martha-Marie Kleinhaus and Roderick A. Macdonald, 'What is a Critical Legal Pluralism' (1997) 12 *Canadian Journal of Law and Society* 25.

¹⁰ Griffiths, *supra* note 6, at 7; Merry, *supra* note 6, at 871.

¹¹ Hans Kelsen, *Teoria Pura do Direito* (4th edn, Coimbra: Arménio Amado (ed.), João Baptista Machado (trans.), 1976) *Reine Rechtslehre* (Vienna: Verlag Frank Deuticke, 1960) ch. 6; Waldron, *supra* note 2, at 138 *et seq.*

¹² Jeremy Waldron, 'Legal Pluralism and the Contrast between Hart's Jurisprudence and Fuller's' in Peter Cane (ed.), *The Hart-Fuller Debate in the Twenty-First Century* (Oxford/Portland, OR: Hart Publishing, 2010) 141 *et seq.*

¹³ *Ibid.* 138-40.

¹⁴ H.L.A. Hart, *The Concept of Law*, Clarendon Law Series (Oxford: Oxford University Press, 1961) 97-107.

¹⁵ *Ibid.* 116-20.

¹⁶ *Ibid.* 118-20.

¹⁷ *Ibid.* 79.

¹⁸ *Ibid.* 100-103.

traditional legal systems (with their own methods of enacting law and with their own rules to apply it, even if they are based on oral transmission and include ordalia). Hart refers to pre-legal societies consisting only of primary rules, where there are no officials; and, in that case, the rules must be widely accepted by the group, no distinction existing between obedience to rules (by the normal citizen) and acceptance of legal validity (by the official).¹⁹ This is connected to the fact that in traditional communities there are no individual rights and duties as opposed to the community's rights and duties.²⁰

Even if those systems, still to be found in substate communities belonging to states recently formed, acquire a status of legality by Hart's rules of recognition, the latter seem to imply that colonial and post-colonial legal systems will determine the validity of the former. In fact, these are recognized by officials (e.g., the tax administration or tax judges) whose competence is given approval in a constitutional legal system.

In other words, Hart's concept of law does not exclude non-state law, and in this sense is able to grant us some framework for the analysis of legal pluralism in developing countries undergoing a tax reform. However, since traditional legal systems are pre-legal for Hart they are not included in the concept of law, unless we see them in a dynamic perspective and conclude that in a colonial and post-colonial setting they are habitually accepted by the majority of a community, involving both private persons and officials provided with authoritative criteria.

In Hart's concept of law, obedience and validity will be congruent in non-pathological situations, but dynamic situations, such as colonized states becoming independent, will lead to changes in rules of recognition. Even if some of the previous colonial legislation is still in force, it will only be valid if the rule of recognition locally accepted grants it validity.²¹ This is the case where post-colonial rules of recognition acknowledge traditional tax rules and solve any conflicting overlapping problems with the colonial tax law still in force (for example, a post-colonial constitutional rule accepts that traditional poll taxes coexist with state and municipal taxes, contrary to the colonial income tax code still in force). Hart's rules of recognition grant us by their nature the criteria to solve conflicts among plural legalities at the application level,

¹⁹ *Ibid.* 114.

²⁰ See Jürgen Habermas, *Faktizität und Geltung, Beiträge zur Diskurstheorie des Rechts und des demokratischen Rechtsstaats* (2nd edn, Frankfurt-am-Main, 1992) 39–45.

²¹ Hart, *The Concept of Law*, *supra* note 14, at 117.

where constitutional rules will normally prevail above others, and therefore any moral concept of law is unnecessary to solve such conflicts.

For the purposes of this chapter, the dynamic dimension of 'pre-legal' and 'legal' systems is taken into account. Moreover, the meaning of traditional rules adopted here, includes Hart's 'pre-legal' set of rules and the rules of the diverse communities coexisting in a certain state and originally belonging to different states, nations, cultures and languages. Furthermore, for the purposes of its relevance to the process of tax legal drafting, it is assumed that these communities reside in a developing country undergoing a tax reform.

III. ACKNOWLEDGING LEGAL PLURALISM AS THE BASIS FOR A SUCCESSFUL TAX REFORM

Legal pluralism is far from being exclusive to developing countries or ex-colonies of European countries. Legal drafting in the current globalized world is characterized by a plural discourse, where legal players, although originally having different backgrounds, are used to critically sharing and spreading their legal knowledge and values, in global discussion forums, such as the OECD, the Global Forum, the International Monetary Fund, the World Bank, the European Union, the Inter-American Center of Tax Administrations (CIAT), the International Fiscal Association (IFA) or the European Association of Tax Law Professors (EATLP).²² In this context, the global legal discourse travels fast in respect of every legal field, and is a product of global identity, solidarity, and a sense of global fairness and unfairness, global human and fundamental rights.²³ Examples of this in tax law are the awareness of phenomena such as tax evasion and avoidance by certain groups of taxpayers, the consequences of tax secrecy and tax havens for each and every country, the importance of exchange of information on tax matters,

²² Klaus Günther, 'Rechtspluralismus und Universaler Code der Legalität: Globalisierung als Rechtstheoretisches Problem' in Lutz Wingert and Klaus Günther (eds), *Die Öffentlichkeit der Vernunft und der Vernunft der Öffentlichkeit*, Festschrift für Jürgen Habermas (Frankfurt-am-Main: Suhrkamp, 2001) 541.

²³ Amartya Sen, *Identity and Violence: The Illusion of Destiny* (New York/London: W.W. Norton & Company, 2006) e.g. chs 2 and 7; Boaventura Sousa Santos, 'Por uma Concepção Multicultural de Direitos Humanos, Reconhecer para Libertar, Os Caminhos do Cosmopolitismo Multicultural' in B.S. Santos (ed.), *Civilização Brasileira* (Rio de Janeiro 2003) 427–551.

the right to a fair hearing in tax litigation, information duties and the *nemo tenetur se ipsum accusare* principle, among other ones.

The aforementioned international legal players tend to favor best practices and seek to reduce diversity and this also explains the reciprocal influences that characterize tax legislation policies. In some domains, solutions are a theme with variations as in a classical composition, in respect of which the interpreters (tax administration, domestic courts and taxpayers) will make the difference. For example, VAT and transfer pricing rules are similar in many tax systems as a result of the aforementioned discourse. Yet, their correct application is far from satisfactory and tax administrations can seldom hire the best interpreters to bring the enacted tax rules, amendments and reforms into a fully successful application. The situation is even more critical in developing countries, where those interpreters will never be hired. The story is different in respect of legal drafters, since time spent and degree of difficulty are significantly less than time and difficulty required in correctly interpreting and applying the law and because legal drafters with comparative law backgrounds provide technical assistance, as is the case for our external legal drafter, in the framework of international assistance programs, such as those of the IMF or the World Bank.

IV. FACTICITIES AND VALIDITY: HABERMAS AND TAX REFORM

Hart's rules of recognition are relevant in this chapter in order to solve any conflicts among plural legalities. However, it is contended here that Hart's rules of recognition are insufficient to grant validity to legal systems, since validity requires that the rules are the product of genuine argumentative interaction among the representatives of different legalities (facticities in the Habermasian sense)²⁴ and that includes tax reforms. As a consequence, it is herein contended that the rules of recognition also have to be valid in the Habermasian sense.²⁵ Thus, our Hercules legislator will not only have to deal with the plural legalities in force and the rules of recognition, but also solve the challenges of facticity and validity and the tension resulting therefrom.

²⁴ These concepts are therefore used here in the Habermasian sense and further discussed below: see Habermas, *supra* note 20, at 32–55.

²⁵ *Ibid.*

In this context, facticity broadly corresponds to the individual legalities in force in a certain state, as stated by each participant in a communication discourse. Those individual legalities may include strict tax legalities, if there are any (for example, traditional poll taxes and taxes on transactions, language and currency used in tax accounting duties), and legalities with consequences in a tax regime (such as the concept of marriage and family, traditional contracts and inheritance rules).

First, consider the example of the family unit for tax purposes. Are polygamous marriages recognized by state tax law, for the purposes of aggregate taxation and allowances? In a state facing diverse meanings of marriage are all of them valid, in a communication process? In a dynamic and normative perspective, should all of them be recognized by state tax law?

Second, consider the example of how tax rules apply to diverse immigrant communities in a state. Assume that an immigrant community organizes itself according to its own economic rules, which differ from the rules of the mainstream population, and that its economic activity is subsidized by its state of origin. As a condition for investing in our developing country that community requires that its tax accounting is accounted for in its own language; it moreover requires that the value of the transactions carried on in the course of business is written down in its own or another foreign currency. Do the principles of equality and of the market economy require a free use of diverse languages for tax purposes? Do they require that transactions are to be accounted for in any currency? Does, in contrast, the ability to pay principle require that every immigrant community has to account for its economic transactions in the language of the host country, for tax purposes? Does the principle of a sovereign state require that transactions are exclusively written down, for tax purposes, in its national currency?

Facticities and legalities will hereinafter be used as synonyms. It is assumed here that each kind of legality will be directly or indirectly represented in the legislative commission. In turn, validity is the result achieved by the argumentative interaction among those participants and among the members of the parliament in a democratically elected assembly voting on the tax reform.²⁶ This implies that our external legal drafter will have the opportunity to be aware of the rules derived by traditional legalities, the rules derived by colonial inheritance, the rules that will attract foreign investment in general and some foreign industries in particular (e.g., oil companies) and the rules that will allow the country

²⁶ *Ibid.*

to be part of the international tax legal community. She will have to acknowledge to an adequate extent each of these legalities and, like the Hercules judge, our Hercules legislator will have to find a coherent compromise among them. Through that coherence she will seek to ensure that her drafts become law reform proposals and ultimately legislation in force (becoming a fact and valid).

As mentioned above, a Hercules legislator has to draft her proposals in a foreign legislative commission hosting her, to which she presents her fundamental ideas on a certain tax code and corresponding essential tax elements (tax object, tax subject and the quantification elements) – hereinafter, the legal type of tax.²⁷ If she starts by presenting her model or the legal type of tax corresponding to what she believes to be a universally valid tax code, she will do it using her previous background.

In the context of drafting new legislation for a foreign legal system, the external legal expert's initial proposal is a 'fact', and not the 'real truth' in the Habermasian sense.²⁸ Facts are statements corresponding to mere individual truths that the external legal expert wants to communicate to the addressee (the national legislative commission, her clients) as an objective truth. This objective truth is a valid solution,²⁹ a best practice. However, it is only the starting point, and as such, facts and individual truths brought by the external legal drafter are not the 'final assessment'. To achieve validity in the host legal system implies acting by communicating, and this requires her to carefully consider her clients' facticities.³⁰ She is expected to act in this commission through genuine communication and critical reasoning aimed at reaching an agreement on the right tax solutions.

For the Hercules legislator, like the Hercules judge, coherence will result from a compromise among different legal principles coexisting hand-in-hand, and from correct interpretation of those principles. For example, the meaning of wealth and of ability to pay can be different for different religious and community groups, for inhabitants of the countryside and for those residing and working in the city, for the different cultural communities and nations. An external legal drafter facing plural legalities will have to interpret them and try to reach a compromise that should be a right answer – in order to represent it in the communicative discourse, a normative perspective will be adopted, as will be explained below.

²⁷ Dourado, *supra* note 4, at 16.

²⁸ Habermas, *supra* note 20, at 29 *et seq.*

²⁹ *Ibid.*

³⁰ *Ibid.* 30–31.

However, unlike the role of a judge, who arguably can grant the right answer,³¹ a Hercules tax legislator can merely aim at a right answer, not only because it is imaginable that the combination of facticities can be achieved in more than one valid manner (for example, what is taxable wealth and what is the amount of tax to be imposed), but also because a legislative right answer is general and abstract (it has also been claimed by some of the literature that what Dworkin's Hercules judge can reach is merely a *right answer* instead of *the right answer*).³² Whereas the Hercules judge interpreting conflicting principles in a concrete case will determine the validity of some of them in that case and leave others dormant, our Hercules legislator when excluding some legalities from her draft law will assess them as invalid as a result of a communication process and on the basis of critical reasoning. Detailed process rules regarding competence, political representation in parliament, frequency of parliamentary sessions, enacting procedures, constraints and others in the legislative procedure are all relevant to a law that aims to be valid, but they are not the focus of this chapter.

If the communication process with the legislative commission composed of national authorities is not carefully handled, and if the national authorities do not in turn represent the plural legalities in a certain state legal system, it is likely that the enacted tax law will not be valid, because it will not be recognized as such by all relevant players: tax administration, tax judges and the different communities of taxpayers. One of the major challenges for our Hercules legislator is to assess whether and to what extent traditional facticities are valid. In order to assess this, she and the legislative commission have to verify whether those traditional truths can be critically discussed in the communication process: for example, whether the enforcement of a traditional tax system is recognized by the addressees, whether it is enforced on the basis of a traditional authority or a religious one, or whether there are individual rights resulting from any taxes paid to traditional authorities. If traditional facticities cannot be critically discussed and are respected on the basis of mythical, ritual and cultural transmission of knowledge, if those truths are enforced by a traditional authority or a religious one, and if human penalties are secondary, they will not qualify for the communication process and will not be assessed as valid.³³

³¹ See *supra* note 1.

³² Jules L. Coleman and Brian Leiter, 'Determinacy, Objectivity, and Authority' in *Law and Interpretation, Essays in Legal Philosophy* (Oxford/New York, Clarendon Press, 1997 (1995)) 214–15.

³³ Habermas, *supra* note 20, at 39–41.

The result achieved from this communication process aims to be valid over time, but our external legal drafter will be aware that the validity of some of the rules of the legal type of tax will be relative both in time and in space. More concretely, the timeframe of validity depends substantially on the type of tax code and tax elements that are handled in a tax reform. For example, a general tax code will tend to be valid for a long period, whereas the validity of a corporate income tax will very much depend on the underlying domestic, regional and international economy and on the domestic political regime and corresponding policies. Moreover, within a corporate income tax code, some rules corresponding to the legal type of tax are more stable (tax object, tax subject and some aspects of the tax base, such as the option between source and worldwide taxation or the meaning of profits and costs), and others less stable (the ones corresponding to the quantification of the tax, such as deductible costs).

Whereas approval of the more stable group of rules is normally subject to the parliament's competence, approval of the less stable group is often delegated to the Ministry of Finance or to the tax administration³⁴ and implying a faster approval procedure. The same distinction between groups of tax rules – more stable and less stable ones – applies in respect of their universal validity (validity beyond national frontiers of the legal tax solutions agreed upon).

In general, however, contrary to the validity of legal solutions considered by Habermas,³⁵ validity in tax law is often limited to relatively narrow time and space frames. This is because taxes are very much dependent on other legal and economic institutions and policies and the latter vary quickly in the current era of open and globalized economies. The only exceptions are the fundamental principles of tax law, which may be granted either constitutional ranking or are in general tax codes.

A. Plural Legalities Ignored by the Legislator and the Role of Tax Officials and Traditional Authorities

This chapter focuses on legal drafting, but difficulties and constraints regarding legal interpretation also have to be mentioned. Consider again the example of the married tax unit. Imagine that income tax law provides for a tax regime for married couples that is more favorable than the one applied to single individuals. Marriage, for the purpose of personal income tax, means monogamous heterosexual marriage.

³⁴ Dourado, *supra* note 4, at 22.

³⁵ Habermas, *supra* note 20, at 36–7.

although in that country, Muslims, Animists, Christians, Hindus and many other religious and atheist communities coexist. If it is accepted here that this example illustrates a case of underlying conflicting legalities that have not been solved in a satisfactory manner by the state law, the application of law by state officials – administration and courts – will imply an assessment of the multiple legalities in force, in order to reach the whole and the inner morality of law.³⁶ The latter will be reached by the official in the manner in which she manages to combine the diverse legalities, but its achievement will be better or worse depending on the state legal conditions to become an agent of the administration, a judge, or an arbiter and to exercise those functions.

If a state manages to grant some central guidance by a precedence rule to the courts, or by somehow imposing settled case law by supreme courts on lower courts, and by rulings by the central tax administration that bind the different tax departments and officials, then the aforementioned subjective combination of legalities by each official will turn out to be a combination achieved with some harmony by the state officials. The more the central state guidance is exercised and is binding, the faster the plurality of legalities will convert into a state legal order, accommodating the underlying legalities and contributing to the effectiveness of the separation of powers in tax law, generality of law and equality. Application of state law by officials can be combined with the nomination of a local authority or arbiter, to resolve disputes according to a traditional legality in a certain cultural community.³⁷ The local authority or arbiter can act either alone or by integrating a jury of state officials, who have discretion to combine state and non-state law according to the concrete circumstances of the case.

Later in this chapter we will refer to the dynamic perspective of legal pluralism in contemporary developing countries. At this point, it is enough to note that the requirements to be a public official or an arbiter applying a traditional legality are dictated by state law or regulations and the same is true in respect of procedural rules (competence, law

³⁶ On the inner morality of law, see Lon Fuller, 'Positivism and Fidelity to Law: A Reply to Professor Hart' (1958) 71 *Harvard Law Review Forum* 630 at 637, 645; and on that inner morality being applicable not only to the state legal system but also to 'subordinate legal systems', see Lon Fuller, *The Morality of Law* (revised edn, New Haven, CT: Yale University Press, 1969) 126; Waldron, *supra* note 12, at 150–54.

³⁷ On non-state justice systems and their relationship to state justice systems: see Miranda Forsyth, 'A Typology of Relationships between State and Non-State Justice Systems' (2007) 56 *Legal Pluralism and Unofficial Law* 67.

applicable, etc.). State law may well provide for or authorize a combined application of traditional and state law by those officials and arbiters.

However, if it is expected that the officials exclusively apply state law, the inner morality of the whole will depend on the recognition of the state law by the officials, and assuming Hart's rule of recognition³⁸ applies, the submission of those officials to the state law in detriment to other legalities, is a question of degree, and will depend on how much discretion state law will grant the officials. Depending on the field of regulation, there can be both positive conflicts and recognition between these officials and their respective functions, on the one hand, and the traditional authorities accepted as such by the pre-colonial society rules, on the other hand.

In any case, the dynamic of legalities within a particular country implies that conflicts among them will not always be solved at the level of the enacted tax reform, that is, at the level of the written law. On the one hand, not all conflicting legalities will be foreseeable, and on the other hand, the balance among them is to be found in a dynamic perspective. For this assessment, it is irrelevant whether an external legal drafter proposes a tax reform or whether the latter is exclusively carried out by national committees and by the national parliament. It can be assumed, as a general proposition, that there will be more conflicts if external legal drafters intervene, since they may not be familiar with the different legalities. However, our Hercules legislator knows that if she becomes acquainted with the plural legalities in force she will avoid some conflicts that may occur among them at the moment of application, even if it is not possible to solve all of them in the enacted state law.

If the rules of recognition still accommodate some non-state rules, namely, by granting discretion in some tax matters to the officials, validity of the tax reform will be more likely to be successful in space and time. The vaguer the norm, the more it will accommodate the complexity of society, different normative viewpoints and appropriateness to the concrete case will be a decision left to the application level.³⁹ However, in respect of tax base rules and tax offences rules, legal vagueness should be avoided if the level of corruption among officials is high (see section VIII B below).

In order to test whether our external legal drafter has managed to reach validity of a tax reform in a communication process, the application

³⁸ In the sense of Hart, *supra* note 14, at 97-120.

³⁹ See Klaus Günther, *The Sense of Appropriateness: Application Discourses in Morality and Law* (John Farrell (trans.), New York: State University of New York Press, 1989) e.g., 77-85, 113-35, 167-70.

moment is crucial: whether the instances applying the law recognize that state tax law as valid (Hart); whether they recognize it as the only valid law or valid at all if it is not inherently moral (Fuller); whether after a tax reform non-state legalities oppose state legality and to what extent the former are still recognized by the competent officials; and whether the competent officials are granted discretion by state law in order to weigh other legal rules enacted by non-state authorities.

V. COMPLEXITY OF LEGALITIES

A. Vertical and Horizontal Dimensions

The complexity of the legalities that can be found in our developing country can bring together the whole amount of combined possibilities an academic can imagine in a theoretical exercise and, with them, some constraints on a tax reform compliant with the rule of law. The multiple legalities can be divided in a vertical dimension (and by that is meant the state versus traditional legalities) and a horizontal dimension (meaning the relationship among the different traditional legalities).

In a vertical dimension, the multiple legalities may be separate and prohibited by state law, may be separate but ignored by the state (i.e., tolerated) or may be explicitly recognized by state law.⁴⁰ For example, a poll tax charged in a traditional community by the traditionally recognized authority may be incompatible with the constitutional ability to pay principle and in that case prohibited, it may be ignored by state law or it may be expressly foreseen by state law.

Non-recognition of different legalities by state law can be as damaging as their prohibition. In relation to our example of marriage above, if the state law only recognizes certain types of private contract, such as monogamous marriage between two persons of different sex, it does not prohibit other marriages concluded according to different rules and legalities, but it will not recognize any rights resulting thereof. State non-recognition will amount to state discriminatory treatment, in respect of taxes, if monogamous heterosexual couples and corresponding family aggregates are handled in a more favorable way than other couples or unmarried individuals.

Another example relates to the application of property tax exclusively to the onerous transfer of building sites ('urban immovable property'),

⁴⁰ See Facchi, *supra* note 6, at e.g., 3-11, 37-45, 51-7.

where the transfer of land ('rural immovable property') is not taxable. This tax regime is justified by a constitutional prohibition (state legality) to the transfer of land (land belongs to the state and cannot be transferred).⁴¹ Nonetheless, the right to use and exploitation of the soil for agricultural, industrial, commercial or building purposes, as well as sites built on it, can be transferred. The right to transfer the use and exploitation of the soil between private parties is granted by the municipalities and a fee is charged upon that transfer. Furthermore, a market price is being applied between those private parties to this transfer: the market price will vary according to market elements such as dimension and location and will be reflected both in the market and in the effectively applied price. These private contracts are tolerated but not recognized by the state (and municipalities), and state law does not grant them any tax value either. The result of this complex set of legalities is that the transfer of land will have a more beneficial tax treatment than the sale of a building site and this will lead to distortions.

Different vertical legalities in force can equally be recognized in the coexistence of state, regional and municipal rules, binding international law and law enacted by international organizations to which a state belongs. The latter meaning can be found in federal states and in regional integrations, such as the Member States of the European Union⁴² and many others around the world, including developing countries and within these African sub-Saharan countries (e.g., OHADA⁴³ and SADEC).⁴⁴

In a horizontal dimension, different legalities can coexist under the umbrella of the same state and of the same state law (e.g., Muslims and

⁴¹ Mozambican Constitution, arts 109 and 110.

⁴² Miguel Poiars Maduro, *We the Court: The European Court of Justice and the European Economic Constitution* (Oxford: Hart Publishing, 1998); Miguel Poiars Maduro, 'Contrapunctual Law: Europe's Constitutional Pluralism in Action' in Neil Walker (ed.), *Sovereignty in Transition* (Oxford: Hart Publishing, 2003: 501-37; Miguel Poiars Maduro, *A Constituição Plural, Constitucionalismo e União Europeia* (São João do Estoril: Principia, 2006) chs I, IV; Koen Lenaerts, 'Constitutionalism and the Many Faces of Federalism' (1992) 38(2) *American Journal of Comparative Law* 205.

⁴³ The Treaty of the Organization for the Harmonization of Business Law in Africa was signed on 17 October 1993, and the OHADA has 16 member states: Benin, Burkina Faso, Cameroon, Central African Republic, Comoros, Congo, Ivory Coast, Gabon, Guinea, Guinea-Bissau, Equatorial Guinea, Mali, Niger, Senegal, Chad and Togo. This number is likely to evolve to include new members, whether or not members of the Organization of African Unity (OAU). The signatories to the OHADA Treaty are also members of the CFA (common currency linked to the French franc).

Animists) in multiple adjacent communities without dialogue and interaction and that amounts to mutual tolerance of the adjacent communities without the recognition of their rules as binding outside each of the communities.⁴⁵

It is here assumed that our developing country constitutionally recognizes fiscal and regulatory competence of municipal communities and that it is member of a regional integration the treaty of which is inspired by the Treaties of the European Union. The first assumption corresponds to the horizontal dimension of legal pluralism, and may facilitate coexistence of different local taxes based on traditional legalities. The second assumption corresponds to the vertical dimension of legal pluralism and will lead to an increase of transplanted categories. The dynamic dimension of legal pluralism and the assessment of transplanted categories in the context of tax reforms in developing countries will be discussed below.

B. Global Tax Legal Discourse and its Layers of Influence

It is contended here that the global legal discourse should have different layers of influence. In private legal relations or private law fields, such as family law, the global dialogue is restricted to areas of fundamental rights, or to a certain concept of the rule of law, at least where that discourse is essentially liberal and tends to acknowledge diversity.⁴⁶ In contrast, in respect of global business, the global discourse aims at handling multinationals, charities, and other non-governmental organizations, according to uniform principles and rules. The fact that developing countries are not able to influence the rules of the current global order leaves them the 'tragic choice'⁴⁷ between granting full tax incentives in order to attract investment by multinationals, and accepting sophisticated and controversial rules adopted by OECD member states,

⁴⁴ South African Development Community Treaty, 17 August 1993, as amended. SADC has the following members: Angola, Botswana, Lesotho, Malawi, Mozambique, Namibia, Swaziland, Tanzania, Zambia, Zimbabwe.

⁴⁵ See, e.g., Facchi, *supra* note 6, at 3 *et seq.*

⁴⁶ For example, Ayelet Shachar, *Multicultural Jurisdiction, Cultural Differences and Women's Rights* (Cambridge: Cambridge University Press, 2001) 45-63; and also Werner Menskim, 'Indian Secular Pluralism and its Relevance for Europe' in Ralph Grillo *et al.* (eds), *Legal Practice and Cultural Diversity* (Farnham/Burlington: Ashgate, 2009) 31-47; Gordon R. Woodman, 'The Challenge of African Customary Laws to English Legal Culture' in *Legal Practice and Cultural Diversity*, *id.* 135-47.

⁴⁷ See Tsilly Dagan, Chapter 3.

such as arm's length transfer pricing rules, and which are also unsatisfactory to the latter states. This very often means that developing countries have to be satisfied with only appearing on the map of international investment, even if by reducing corporate tax rates and granting tax holidays to international investment, in order to participate in the uncoordinated global tax competition.⁴⁸ Sometimes, they create offshore centers to become destinies of dematerialized financial services. It is disputed that offshore centers bring economic benefits from a worldwide point of view⁴⁹ and they seem to contribute very little to the GDP of inefficient host developing countries, except by creating an obscure area outside the state control, or a parallel state the rules of which are unclear, and by granting loans at interest rates generally not available to the local population and local investment.⁵⁰

Global norms of taxation are not, however, restricted to taxation of multinational companies, or to non-governmental organizations operating worldwide, but also apply to other taxpayers. In fact, international legal players tend to export rules in respect of every taxpayer, including medium and small-sized companies and individuals. The reason for this seems to be the use of a basic legal language and technique, understood by a drafter as the only one that brings legal preciseness to a legal system and improves it. Tax concepts such as net income, resident taxpayer, source of income, permanent establishment, depreciation, proportional or progressive rates, and withholding taxes are in their broad terms common to every jurisdiction. Where some jurisdictions have identified tax planning activities, especially cross-border tax planning activities and have generated a legislative reaction to such tax planning, these may prove to be best practices that could be followed by other jurisdictions, whether they are OECD member states or developing countries.

Whereas pure exportation of legal solutions will lead to uniformity without the recommended critical analysis, such best practices should be critically reviewed taking into account their appropriateness for the

⁴⁸ Clemens Fuest and Nadine Riedel, 'Tax Evasion, Tax Avoidance and Tax Expenditures in Developing Countries: A Review of the Literature', *Report Prepared for the UK Department for International Development*, I-VI, 1-69, spec. 39-46, available at http://94.126.106.9/R4D/PDF/Outputs/EcoDev/60670_TaxEvasionReportDFIDFINAL1906.pdf.

⁴⁹ *Ibid.*

⁵⁰ See, e.g., the offshore regime in São Tomé e Príncipe, Decree-Law No. 61/95, *Diário da República de S. Tomé e Príncipe*, 31 December 1995, 3.º Suplemento; Decree-Law No. 70/95, *Diário da República de S. Tomé e Príncipe*, 31 December 1995, 7.º Suplemento.

country undergoing a reform.⁵¹ Full rejection of globalization would not only imply rejecting global business, but also exchange of ideas and knowledge.⁵²

VI. A NORMATIVE AND DYNAMIC APPROACH TO LEGAL PLURALISM

If a tax reform does not comply with some of the existing plural legalities, and in its application, administrators are not granted discretion to apply non-state rules, the consequence will either be generalized tax evasion in respect of state taxes and corresponding complicity by the officials or pressure to impose state law if the authorities accept the rule of recognition. Nevertheless, the acknowledgement of plural legalities in force in a developing country does not imply that all of them will be accepted in a tax reform. Our Hercules legislator will handle plural legalities not only in a descriptive perspective, but also in a normative one.⁵³ Achieving validity of a tax reform in the Habermasian sense also implies a normative perspective of legal pluralism.

The rule of law is inherent to this normative perspective, since it contains criteria that should apply universally, and therefore, also to developing countries in the context of globalization. Our external legal drafter will also take into account the dynamic nature of legalities, that is, that pluralistic settings evolve. A resolution of tensions among and between legal pluralities ideally leads to (valid) rules of recognition that contain criteria that solve any emerging conflicts uniformly. Validity of the tax reform depends on the communication process, on the rule of recognition and also on its inherent morality – ultimately, on whether the rule of law is accomplished.⁵⁴

This approach is required to modernize a tax system, and improve its justice and efficiency by taking into account comparative legal solutions.

⁵¹ See a critical perspective on globalization of pseudo universal categories: David Schneiderman, 'Commentary, Pluralism, Disagreement, and Globalization: A Comment on Webber's Legal Pluralism and Human Agency' (2006) 44(1) *Osgood Hall Law Journal* 199 at 205-9.

⁵² Sen, *supra* note 23, at 122-5; Santos, *supra* note 23.

⁵³ On the descriptive and normative levels of legal pluralism, see Waldron, *supra* note 12, at 136-7. See also, William Twining, 'Normative and Legal Pluralism: A Global Perspective' (2009-2010) 20 *Duke Journal of Comparative and International Law* 473.

⁵⁴ See Fuller, *supra* note 36.

The absence of that perspective would mean ignorance and carelessness, and a barrier to the movement of values, knowledge and ideas that can contribute to mutual understanding and improvement of the situation of the most disadvantaged members of a society and of the world population.⁵⁵

The normative dimension assesses legal pluralism as a dynamic process, justifies amendments to law and reforms based on local and universal principles inherent to the rule of law, as well as policies aimed at a certain result. It ultimately aims at reaching unity instead of pluralism, for the sake of the principles of generality and equality. Similarly to the Hercules judge, who is expected to fulfill the principles of certainty and legitimacy by a coherent reasoning, in order to reach a unitary answer, our Hercules legislator will use substantive arguments (reasoning) and seek an agreement rationally motivated.

Thus, in a normative and dynamic perspective, unity of law will result from the parliament's decision on the basis of a proposal drafted by experts that take into account plural legalities and as long as the community and officials accept the corresponding rules of recognition.⁵⁶ A parallel between the concept of law, its validity in the static perspective, and its validity in the normative and dynamic perspectives (the perspective of reforms) can be drawn with the public choice theories and welfare economics, respectively, where for the former, justice is assessed in light of the procedural criteria adopted (procedural aspects assessed in themselves, on their legitimacy and illegitimacy) whereas for the latter equity and efficiency are a result of a trade-off.⁵⁷ The validity in the normative and dynamic perspective – the perspective of a reform – fulfills the purpose of material justice in a more satisfactory manner. In other words, the normative approach to legal pluralism implies not only an assessment on legitimate procedures – whether legalities are valid or not – but also a material assessment of the legalities and their potential overlap.

If a Hercules legislator proposes what she considers to be the best legal solution, plural legalities also have to be assessed in light of the rule of

⁵⁵ Sen, *supra* note 23, e.g. chs 2 and 7; Santos, *supra* note 23.

⁵⁶ See this dynamic perspective in Waldron, *supra* note 12, at 150–55.

⁵⁷ See, e.g., A.C. Pigou, *The Economics of Welfare* (3rd edn, London: Macmillan, 1929); Amartya Sen, 'The Impossibility of a Paretian Liberal' (1970) 1 *Journal of Political Economy* 152; versus James Buchanan, e.g., *The Demand and Supply of Public Goods* (Chicago, IL: McNally, 1968) and Gordon Tullock, 'Problems of Majority Voting' in K. J. Arrow and T. Scitovsky (eds), *Readings in Welfare Economics* (London: George Allen & Unwin, 1969) 169–78.

law parameters considered adequate to a certain state in the world. It is not important that legal solutions are exported in one or the other direction, the important aspect is that the best practices and solutions are adopted wherever they are adequate.⁵⁸

Contrary to the situation assumed under section IV, above, if our Hercules legislator carefully steers the process, some conflicts among plural legalities at the application level will be avoided, and the competent officials will seldom have to solve conflicts among primary rules when applying rules of recognition. State law will incorporate the traditional legalities that were judged as valid during the communication process and the rules of recognition will assess state law as valid.

In the next sections it will be discussed how the normative and dynamic perspectives of legal pluralism apply to a tax reform.

VII. FROM PLURALISM TO UNITY IN TAXES

A. Common Colonial Tax Regimes, Common Constraints and Common Challenges

Let us now assume that our Hercules legislator will be in charge of reforming taxes not only in one developing country but in a group of them with a common political and legal (past) history, because they were colonies of the same colonial master. The first round of tax reforms in each of those countries is based on a common tax legal history, a colonial tax system, with schedular taxes and flat rates and no separation between the tax administration and the tax courts (no independent tax courts). It can moreover be assumed that tax reforms and corresponding introduction of global and progressive taxation of income and of a value added tax has been delayed in each of those developing countries, because they went through a socialist period immediately after independence, and during that period, the colonial tax system was kept in force.

Each of these developing countries is willing to apply a non-discriminatory tax regime independently of the nationality of the shareholders (in the sense that no major obstacles exist to constituting a company and to providing services to any of these developing economies). It is also assumed that they are, at least formally, rule-of-law states. Separation of powers is a provision included in their written

⁵⁸ See, in a broad context, Sen, *supra* note 23, at 122–4.

constitutions, although the extent to which that separation of powers is effectively applied is not totally known.

However, it can be concluded that in those countries where the constitutional court has already declared tax laws unconstitutional, namely, because the government has passed decree-laws without being authorized by parliamentary law, separation of powers is working in a satisfactory manner. Literacy of population and tax administration and corruption indexes are broadly taken into account for the purposes of the reform, since the former are presumed to be relatively low outside the main cities and the latter to be relatively high throughout the territory of those countries. Both the low literacy of the population and corruption are constraints to the tax reform, because they will be an impediment to equality (of 'subjective freedoms in action') and consequently to the communication discourse and to validity of laws.⁵⁹

The purpose of introducing tax reforms coincides with the opening of those economies to the market. Our developing countries rely more on revenues from trade taxes and foreign assistance, have high levels of public debt, and lag behind in terms of public spending regarding basic goods. Legal drafting issues and administrative constraints in their implementation compromise adequate revenues in general, and especially in respect of taxes requiring high administrative skills on application and control.⁶⁰ The classic goals of tax systems and tax reforms corresponding to the most equitable and efficient taxes,⁶¹ even if valid in the context of plural legalities, are not easy to apply to our developing countries, due to the aforementioned constraints.

B. Common Normative Solutions

Taking into account the above, it is necessary for the Hercules legislator to establish a tax reform that finds a balance among traditional legalities

⁵⁹ Habermas, *supra* note 20, at 153–65.

⁶⁰ William Crandall and Jean-Paul Bodin, *Revenue Administration Reform in Middle Eastern Countries, 1994–2004*, IMF Working Paper WP/05/203 (IMF, 2005); Richard M. Bird and Eric M. Zolt, 'Tax Policy in Emerging Countries' (2008) 26 *Environment and Planning C: Government and Policy* 73; Richard Bird, 'Administrative Dimension of Tax Reform' (2004) *Asia-Pacific Tax Bulletin* (March) 134, available at <http://unpan1.un.org/intradoc/groups/public/documents/UNPAN/UNPAN015761.pdf>.

⁶¹ See James Banks and Peter Diamond, *The Base for Direct Taxation*, Prepared for the Report of a Commission on Reforming the Tax System for the 21st Century, Chaired by Sir James Mirrlees (Institute for Fiscal Studies, 2008), available at www.ifs.org.uk/mirrleesreview.

and state legalities. The reform will have to deal with the past colonial legality, the aforementioned economic, social and cultural constraints and the challenges the new state faces in light of globalization and the concomitant aim to attract foreign investment. It is contended here that, in a normative approach, tax principles based on the rule of law have to prevail over the traditional legalities, in the case of conflict (including the principle of ability to pay and the connected tax principles of net income, progressive or at least proportional taxation of individual income, proportional taxation of corporate income, broad tax bases).

As discussed above, there are many ways to design tax laws in line with those principles and the particular approach should depend on the specific economic and social circumstances of the country undergoing a tax reform and on the policies to be followed. Even so, modernization of the colonial tax system complying with the rule of law will require application of general recommendations. Assuming that the country is able to attract investment in diversified economic sectors (such as agriculture, tourism, minerals and oil, building sites, roads and rails, telecommunication, water and energy resources, commerce, research in science and technology), and the services sector is relatively well organized,⁶² these general recommendations include replacing schedular proportional taxes by a single progressive personal income tax (or, more accurately, by a dual tax system) and a single corporate tax, and taxes on transactions by VAT. Whereas income tax will be aimed at a broad tax base, if tax incentives are simultaneously introduced in order to attract foreign direct investment, the tax system will become incoherent. In the current era of global tax competition and regional integration, the reduced ability of governments to tax mobile factors and to raise revenue under corporate income tax put pressure on productive government expenditure (infrastructure, education, health care) that are vital for the group of developing countries we are considering in this chapter.⁶³

In contrast, if the economy and social organization are totally dependent on one industry (for example, the oil industry), and the other economic sectors are non-existent or much simpler, a special tax regime on petroleum operations, combined with simple proportional taxes, will be recommended: a simple tax on business income and services, a wage

⁶² Jean A.P. Clément and Shanaka Aianath Peiris, *Post-Stabilization Economics in Sub-Saharan Africa: Lessons from Mozambique* (IMF, 2008).

⁶³ Liam Ebrill, Janet Stotsky and Reint Gropp, *Revenue Implications of Trade Liberalization* (Washington, DC: IMF, 1999).

tax, a simple excise tax, and an export/import duty tax, all of them with proportional and low rates.⁶⁴

Even if the tax principles and the main aspects of the tax types in a rule-of-law state are identified worldwide and are not exclusive to one or another legal system, they are very much dependent on the recognition of state legality. If a small country with a poor economy lacks basic state organization and cohesion and if traditional legalities prevail, the concept of tax will be practically non-existent. If, moreover, there are no foreign economic operators interested in investing in that country, it is recommended that very simple taxes be adopted, observing the basic principle of ability to pay, that are easy to administer.⁶⁵ The basic effort should then be concentrated in organizing a rule-of-law state and bringing the informal sector into the formal economy.

Every tax system also has to reflect the country's economic structure, its capacity to administer taxes, its public service needs, its access to other sources of revenue such as aid or oil and, in a normative perspective of legal pluralism, the constitutional principles regarding taxes that are common to rule-of-law states and are often part of general tax codes. The tax morale and the tax culture in a certain country and system have likewise to be taken into account and possibly improved.⁶⁶ This requires joint work by the tax legal drafters, improvement of the atmosphere of trust between the taxpayer and the tax administration, and reduction of corruption level by granting morals to the function, through the good example of the top officials, training courses abroad, increase of salaries, reduction of legal indeterminacy in tax base rules and tax offences rules, and strong promotion of independent courts.

Moreover, tax policy has to be connected with the macroeconomic fiscal goals of reducing inflation, interest, budget deficits and public debt to one digit and measures taken to achieve them. Those goals follow the general consensus: broadening the tax base (both in income and consumption taxes), reducing tax rates (especially in income taxes, where corporate income tax and inflation have lead to higher rates than in OECD countries) and improving administration performance through

⁶⁴ See the example of the tax legislation of Timor L'Este: Decree-Law 8/2008; available at www.pwc.com/en_ID/id/publications/assets/east-timor-tax-book-2005.pdf; www.mof.gov.tl/wp-content/uploads/2010/07/Taxes_and_Duties_Act_2008.pdf.

⁶⁵ See Banks and Diamond, *supra* note 61.

⁶⁶ Richard M. Bird, *Tax Challenges Facing Developing Countries*, University of Toronto, Institute for International Business Working Paper Series, IIB Paper No. 12 (2008) 1–33.

intensive investment in new technologies. Efficient organization of the tax administration, through avoidance of labor-intensive structures, and overlapping of functions by different departments, and simultaneously finding a structure that corresponds to the administrative culture of the country, is a challenge in order to avoid spillover of resources.

In this context, legal drafting solutions inspired by comparative law and global tax legal discourse will vary, taking into account the constraints, challenges and the purposes of tax policy in each legal system: for example, either the purpose regarding attraction of foreign investment or the purpose of taxation at source of such foreign investment, through withholding taxes; or a balance between both purposes; the purpose of simplifying the tax system or combating tax avoidance of certain groups of risk or an adequate balance between both of them.

C. Unity, Equality and Validity

It has been mentioned above that traditional tax legalities could be related to taxes imposed by traditional authorities (pre-colonial legalities), to compliance with duties in different languages and currencies and to different concepts of ability to pay that neither coincide with the structure of state taxes nor with the concept of ability to pay according to the state rule of recognition. In a normative perspective, as long as taxes imposed by traditional authorities result from the communication discourse and are considered to be valid by the members of a traditional community in the Habermasian sense, they may coexist with state taxes, since they will not be contrary to the rule of law and to the normative perspective of legal pluralism. Those traditional taxes can be an income tax, a sales tax, a property tax or a poll tax adopting a commonly accepted concept of ability to pay. In such a case, state taxes must take into account the total tax burden imposed on a taxpayer, in order to prevent double taxation resulting from traditional and state taxes leading to confiscatory taxation or generalized tax avoidance and/or evasion. In contrast, taxes imposed by traditional authorities that are not valid in the Habermasian sense described above are to be rejected.

Moreover, state taxes must take into account other legalities with influence on taxes, such as traditional contracts and traditional concepts of wealth, traditional concepts of the family aggregate, as well as contracts based on market rules, but not recognized by state law (such as the transfer of use and exploitation of land to which a market price is granted, beyond the payment of a fee). Otherwise, state taxes will not cover many contracts revealing ability to pay, on the one hand, and will not cover all meanings of the family aggregate, which will lead to

inequities, inefficiencies and abuse. Major challenges to state taxes in a developing country are taxation of multinationals, taxation of the informal sector and taxation of immigrant communities unable to benefit from special tax regimes who seek a privileged treatment in respect of tax compliance.

State taxes must try to cover all valid meanings of ability to pay in the state, even if this leads to some overlapping with infra-state taxes: this is an issue to be solved by an assessment about the vertical tax legalities. Thus, in taxes, unity of law means accepting and discussing the fundamental principles regarding equality among taxpayers, on the one hand (of ability to pay, of direct versus indirect taxes, of worldwide versus source taxation of income, progressivity versus proportionality or the amount of progressivity, global taxation of income versus dual systems, of taxing the formal and the informal sector) and equality among different political communities in the sense of fiscal federalism, on the other hand, and efficiency. The meaning of equality in personal and corporate income taxes is not self-evident, since measuring the ability to pay of an individual is far from undisputed. In fact, equality will very much depend on the concept of income, on the assessment rules, and on whether there is an option between net and gross taxation of income.

In personal income taxes, a decision may have to be taken on whether ability to pay is the individual ability to pay or the ability to pay of a group, such as a family. In that respect, it may have to be discussed whether the ability to pay of a family aggregate is relevant, what is a family aggregate for income tax purposes, and ultimately whether ability to pay of an aggregate as determined by traditional legalities is to be accepted and to what extent. Before unity of law is reached, ability to pay of plural aggregates according to plural legalities could be taken into account and it could be concluded that infra-state taxes or even infra-state fees to tax them would be more adequate than state taxes.

Tax equality in income taxes is also dependent on the concept of income, as well as on what constitutes net income, which assessment methods are adequate, to whom and when they are applicable (direct versus indirect methods), how the informal sector, on the one hand, and groups of companies and multinationals, on the other hand, are to be assessed.

D. Role of Transplanted Categories

The smooth evolution of a tax system calls for the previous colonial system to be taken into account, in order to avoid discontinuities, and that the tax systems belonging to the same legal family are taken into closer

consideration than other comparative solutions. The fact that taxes fall on private law relations and that tax law interacts with nearly all legal fields (constitutional, administrative, company, insolvency, family and inheritance, contracts, penal law and administrative offences law, as well as public international law) also implies that prior attention has to be granted to the domestic legal system, and to those legal systems belonging to the same family.

This is true not only in respect of the written law in force, but also in respect of the courts' case law, since courts often rely on the case law of the ex-colonial master courts, transplanting categories in a more or less accurate way.⁶⁷ Both national courts and tax administration very often quote tax law commentaries and tax books regarding the tax laws of the ex-colonial master. This is especially true for general tax codes and any procedural and judicial process laws.

Two categories of transplanted concepts and regimes have to be taken into account, when discussing tax reforms in developing countries belonging to a certain family of law: the transplanted legal categories imported by tax law from other legal areas, such as dependent workers, independent workers, private property, building sites, land, sale, usufruct, rental, inheritance, gift – where the private and public law domestically written concepts are transplanted from the ex-colonial master legislation in force at the time of the reform; and the transplanted tax concepts or regimes such as taxpayer, allowances, burden of proof. These concepts and regimes can either be transplanted by the legislator or by national courts and tax administration when interpreting domestic law.

Transplantation of legal categories is also a dynamic process involving diversified influences.⁶⁸ Many tax concepts and regimes reveal a universal language, overcoming the traditional division between civil law and common law systems (for example, transfer pricing regimes, beneficial ownership, neutral taxation of restructuring operations, thin capitalization rules). That is due to the lobbying of multinationals, exercising legitimate pressure to benefit from identical or similar regimes worldwide and

⁶⁷ See the discussion on the transplanted categories in the Anglo tax jurisprudence, in Richard Krever, 'Interpreting Income Tax Laws in the Common Law World' in Markus Achatz, Tina Ehrke-Rabel, Johannes Heinrich, Roman Leitner and Otto Taucher (eds), *Steuerrecht, Verfassungsrecht, Europarecht, Festschrift für Hans Georg Ruppe* (Vienna: Facultas wuv, 2007) 354–78.

⁶⁸ On the role of comparative tax law in respect of various tax principles, concepts and tax codes, see Victor Thuronyi, *Comparative Tax Law* (The Hague/London/New York: Kluwer Law International, 2003).

aimed at reducing compliance costs. In general, foreign investors operating in developing countries are willing to be handled in the same manner independently of where they are operating, and this implies that income tax codes, consumption tax codes and general tax laws, as well as tax litigation procedures, are expected to contain some sophisticated regimes that will be a challenge to the tax administration and local courts.

The role played by international organizations such as the OECD, Global Forum, IMF, World Bank, the EU (e.g., TIEAS), CIAT, IFA, EATLP in respect of recommending best practices, providing technical assistance to the concepts and drafting of tax legislation, or providing international fora of debate, has greatly contributed to this universal language both within the OECD and in developing countries and to transplantation of legal categories, beyond the corresponding legal families.

The fact that tax legislation in developing countries is being drafted by lawyers of different legal traditions who meet and discuss in global fora, and/or in the framework of international organizations, grants to comparative law a role that is especially important in this context. Legal pluralism, as a basis for legal drafting of taxes, is experimented with and practiced, on a permanent basis, in an attempt to answer the expectations of pluri-located investors.⁶⁹ Finally, autonomous interpretation of tax concepts and the corresponding rejection of interpretation according to the meaning in the exporting legal field also makes it easier to transplant tax concepts and regimes such as sale, rental, interest.

The phenomenon of regional integration will provoke a dynamic change in the transplantation of categories that cannot be ignored by the external legal drafter: for example, the aforementioned OHADA,⁷⁰ where Guinea Bissau, a Portuguese ex-colony, is a member state among French ex-colony member states, and where harmonization measures are being mainly drafted by French lawyers. Another example is SADC,⁷¹ where Mozambique, also a Portuguese ex-colony, is a member state, among ex-colonies of the United Kingdom, and where many solutions thus are or will be of a common-law type. That change will be bigger if there are independent courts (as in OHADA) with recognized competence for uniform interpretation.

VIII. DRAFTING OPTIONS AND CHALLENGES: MODELS OF LEGISLATION AND FOLLOW-UP OF THE REFORMS

Let us now assume that as a result of the technical assistance program, the work of the external legal drafter and the corresponding communication process in search of validity, a draft on a general tax code is enacted. It can be asked whether the tax principles and rules of a particular tax code that are assessed as valid beyond any legal pluralities and circumstances can be later used as a model of tax legislation. That could be done either by the same drafter or by others. If the drafter of the tax reform is the same expert regarding a group of countries, she will have her own concept of an ideal tax law/system and will tend to adopt as much as possible those ideas.

If a scale is adopted, such subsequent use will certainly be more accurate in legal systems belonging to the same legal family and having comparable economies than in legal systems that, although belonging to the same legal family, have very distinct economies and levels of human development. The latter can occur because their dimension is very different, the economic sectors are very different, the rule of law is observed in a satisfactory manner in one state but not in the other, or in one case there is political stability and in the other there is not.

Thus, as long as the legal background and the political, economic and social environments are similar, there are groups of solutions that can be considered ideal in a rule-of-law state. In respect of the subject topics under a general tax code, it is easier to find a common proposal that will correspond to a current idea of relationship between the tax administration and the taxpayer in a rule-of-law state and to human rights: issues such as interpretation, non-retroactivity, obligations of withholding agents and tax responsibility, tax domicile, transfer of tax credits and debts, prescription, the right to be notified of administrative acts, the obligation to fundamental acts, the burden of proof as a risk of spheres, the right to a fair hearing, the right to be notified before the tax administration implements a new tax assessment, presumptions regarding abusive practices, indirect methods wherever the taxpayer does not comply with his/her legal duties, the principles of investigation of the relevant facts (*Untersuchungsprinzip*) and of the true facts (*materielle richtigkeit der Sachaufklärung, princípio da verdade material*), administrative rulings and their publicity, accounting obligations, voluntary payment and payment in instalments, guarantees of credits, interest for

⁶⁹ See Günther, *supra* note 22. For a critical view on global categories: Nelken, *supra* note 9, at 443–71.

⁷⁰ Mozambican Constitution, arts 109 and 110.

⁷¹ See *supra* note 44.

delayed delivery of tax assessment or for delayed payment of taxes, the principles of legality, proportionality, equity, confidentiality of data.

The same reasoning applies wherever the groups of taxpayers and tax objects can be identified and are similar worldwide: taxation of multinationals, taxation of charities and non-governmental organizations, taxation of the informal sector, taxation of small and medium-sized companies, taxation of interest, dividends and capital gains. Another issue is whether it makes sense to have one legal drafter for the whole tax system, or at least for all direct taxes or income taxes, or for all indirect taxes, and for procedural tax laws. Consistency of a tax system will call for one or a small committee of legal drafters to be responsible for related tax codes.

Enactment of tax drafts ideally involves not only national officials from the tax administration and ministry of finance, but also public discussion with all interested parties, namely, the private sector, practitioners, tax consultants, accountants, and also judges. If the process is public all their comments will be taken into consideration by the national government before submitting the draft to discussion in specialized committees in parliament and to final approval by the plenary. Parliamentary procedures are not, however, the best way to ensure coherence and consistency of the tax regimes: parliaments often introduce amendments in plenary sessions, including last-minute amendments, and this jeopardizes the aforementioned purpose of coherence and consistency of the regime: examples of last-minute amendments are the ad hoc amendments to deadlines granted to the taxpayer in respect of different procedural and judicial process steps, and the amendments to the amount of penalties, without considering the internal consistency of the different deadlines and penalties proposed.

It has also to be taken into account that in developing countries, the negotiation between governments and parliaments take place without the presence of foreign experts, for obvious reasons of sovereignty. Taking into account the lack of national expertise, the amendments in the specialized committee will also more often than not introduce incoherence and inconsistencies to the proposed law and jeopardize the expected results of the law.

Another aspect relates to the fact that where technical assistance in drafting is granted by international organizations, the follow-up of the reforms and their implementation may not be accomplished in an optimal manner. Two problems will often occur. On the one hand, there will be problems related to correct implementation, due to different interpretation of the legislation by the tax administration throughout the country. Rulings often do not exist and case law will not be publicly available. In

the worst cases, either the legislation or the rulings or the case law or all of them will not be publicly available. On the other hand, when the tax legislation enacted faces lobbies and negative reactions from important groups of voters, amendment will often be drafted by the national officials at the tax administration, and even if the underlying purpose may be adequate, the lack of expertise may lead to a technically inconsistent result.

However, if both legislators and officials applying the law use technically deficient legal language, a domestic, neutral result may be achieved, as long as there is agreement on the meaning used.

IX. CONCLUDING REMARKS

This chapter aimed at discussing the role that an external legal drafter should play when invited to assist a tax reform in a developing country. She is an ideal tax law drafter – our Hercules legislator – who aims to acknowledge the plural legalities in force in the host country, the existing constraints and challenges. Plural legalities comprise pre-colonial traditional tax legalities, the colonial tax legality, tax legalities of the various communities originally belonging to different states, nations and cultures and that can overlap either in a vertical or horizontal manner. In order to be fully aware of those facts, she will act through genuine communication with the national tax officials in a legislative committee. She aims at having her tax legal drafts enter into force and be valid, not only by being compliant with Hart's rules of recognition, but also according to the concept of validity in Habermas.

In order to reach validity, she will have not only to identify the plural legalities in force (descriptive approach), but also to adopt a normative and dynamic approach. For this, she will have to select which traditional and colonial legality (or legalities) in force must be included in the tax reform; which ones are to be rejected; which transplanted categories of the ex-colonial master are to be adopted; which global tax concepts can be imported. This normative approach has to comply with the rule of law and inherent principles of taxation.

The fact that our external legal drafter is expected to carry on a very demanding task led us to call her a Hercules legislator by analogy to Dworkin's Hercules judge. It was, however, recognized that although the Hercules judge aims to reach the right answer, our Hercules legislator can merely aim to reach one right answer due to the vast number of combinations her tax law drafts may reveal. Moreover, where validity of law as imagined by Habermas aims at being valid over time, tax reforms

have limited validity in time, due to the oscillation of economic and political conditions and constraints, which is increasing faster in the global order (although the timeframe will vary depending on the tax matters at stake).

Admitting that our Hercules legislator does not exist, this chapter contends that where an external legal drafter plays her role seriously, she will be able to contribute to the validity of a tax reform of a developing country, in compliance with rule of law parameters. Her tax reform will not be the arithmetic sum of the existing pipes, but she will try to represent a valid pipe.

7. The place of law in the evolution of Chinese fiscal federalism

Wei Cui*

I. INTRODUCTION

The importance of tax design for economic development is well understood and uncontroversial.¹ The drafting of tax legislation to implement tax policy in developing countries has also received attention from organizations such as the International Monetary Fund.² However, the role of tax law as a determinant of economic development has been less often explored. What part has tax law, as distinguished from the tax policies that it embodies more or less perfectly, played in either enhancing or hindering development? This is not a whimsical question. Many developing countries in search of appropriate tax policies also have fledgling legal systems. In these countries, a legal – including constitutional – framework for developing and implementing tax legislation cannot be taken for granted. As a result, the legal perspective is often missing or barely present in tax policy debates. By contrast, it is customary for scholars in developed countries to structure discussions about taxation by reference to a wide range of legal doctrines, norms and interpretations. Herein lies a gap between the respective tax policy discourses in developed and developing countries, and legal scholars have a particular stake in assessing the significance of the gap: even if the law cannot be easily dismissed as superfluous, its importance for tax policy in

* I am grateful for comments by audiences at the University of Melbourne, University of Minnesota and Peking University law schools on presentations on the material in this chapter.

¹ See, e.g., Richard M. Bird, *Tax Policy and Economic Development* (Baltimore: Johns Hopkins University Press, 1992).

² See Victor Thuronyi (ed.), *Tax Law Design and Drafting* (Washington, DC: International Monetary Fund, 1996).