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The Reverse Transfer of Technology: Legal and Administrative Aspects of Compensation, Taxation and Related Policy Measures

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CONSIDERATION OF POLICY ISSUES AT THE INTERNATIONAL LEVEL

Legal and administrative aspects of compensation, taxation and related policy measures: Suggestions for an optimal policy mix

Study by Dr. Richard Pomp and Dr. Oliver Oldman

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## Chapter

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Prefatory note by the UNCTAD secretariat

1. The importance of formulating policies for dealing with the adverse consequences associated with the reverse transfer of technology (brain drain) has been stressed in several resolutions and proposals adopted recently by the international community. The General Assembly, in its resolution 3362 (S-VII) of 19 September 1975, Section III, paragraph 10, pointed to the "urgent need to formulate national and international policies to avoid the 'brain drain' and to obviate its adverse effects". In its resolution 2 (I) of 5 December 1975, the Committee on Transfer of Technology of UNCTAD requested the Secretary-General of UNCTAD to "carry out studies assessing the magnitude, composition, causes and effects of the outflow of trained personnel from the developing countries" and to "convene a group of governmental experts to examine the studies and to submit, if possible, recommendations to the Committee on Transfer of Technology at its second session" (paragraph 9 of the resolution). In its resolution 87 (IV), adopted in Nairobi on 30 May 1976, the United Nations Conference on Trade and Development recommended (in paragraph 18) that all countries, particularly those benefiting from the brain drain, should, in the light of UNCTAD's work on reverse transfer of technology "consider what measures may be necessary to deal with the problems posed by such outflow .....". Similar resolutions and recommendations have also been adopted in other United Nations forums, particularly, ILO, WHO and UNESCO.

2. The present study, prepared by Professors Pomp and Oldman, examines some of the legal and administrative implications of policy proposals designed to transfer gains from brain drain to the developing countries. At this stage, the discussion is of a very preliminary nature and merely attempts to outline the main problem areas rather than to suggest solutions.

3. The study is one of several being presented to the Group and forms part of UNCTAD's continuing effort to improve understanding of the brain drain problem, its economic and social implications and the policy options facing the international community. In the planning of this study, the UNCTAD secretariat has benefited considerably from the co-operation of the Department of Economic and Social Affairs of the United Nations Secretariat.
Summary and conclusions

4. This study discusses the legal and administrative implications of transferring to the developing countries part of the benefits accruing both to the migrants and to the developed countries from the reverse transfer of technology (brain drain). The term "brain drain" is used as a portmanteau expression to indicate the migration of professional, technical, and kindred persons (PTKs) from the developing to the developed countries. Though this definition accurately describes a large element of the brain drain, it is restricted in a number of respects. First, countries are not neatly divided into developing and developed. A country that is classified as a developing country for some purposes may be considered as a developed country for other purposes. Second, not all PTK migration occurs between the developing and developed countries. Migration occurs among the developing countries themselves and among the developed countries themselves. Third, the term PTK is too restrictive; for some developing countries, the brain drain may consist in part of businessmen, and international civil servants, persons not usually classified as PTKs. For some countries, the loss of manpower may consist more of unskilled labour than of brain drain.

5. The terms developed country, developing country and PTK, despite their over-simplification, are nonetheless useful in framing the debate, since they serve to indicate the basic nature of the underlying problems without detracting from the general applicability of the discussion.

6. While a number of factors can be identified that contribute to the migration of PTKs, there seems little doubt that since the mid-1960s, the aim of the major developed countries of immigration has been to discriminate, whether or not within the context of overall quota limits, in favour of PTKs to the detriment of the unskilled. The attitude of the United States, shared by other developed countries, has been expressed succinctly by a former Secretary of State: "We are in the international market for brains." Not surprisingly, during recent years PTKs from the developing countries have come to represent an increasing percentage of immigration into the developed countries, thus causing concern over the effect this loss of manpower is having on the economies of the developing countries.

7. The causes of the brain drain are complex, and a number of remedies have been suggested at various times for dealing with the problem. Some suggestions involve direct or indirect restrictions on the flow of migration from developing to the developed countries. These restrictions, however, raise serious conflicts with basic rights under a humanitarian international order and for that reason are precluded from consideration. More recently, it has been suggested that a part of the benefits arising from the brain drain ought legitimately to be transferred to the developing countries. In brief, the proponents of this argument rely on the basic principle that in a world of imperfect mobility, individuals who are able to migrate ought to share some part of their increased benefits in order to improve the welfare of those left behind. The argument is strengthened

to the extent that higher or specialized education, an essential requirement for migration into most developed countries, is accessible only to the children of the political and economic élite, or those living in the urban areas. If a lack of equal educational opportunity exists, those able to migrate exercise a privilege or an exclusively-held advantage and should share their increased benefits with those lacking the same opportunities for educational and economic advancement. Moreover, if the developing country incurs losses due to the migration, as seems likely, the skilled migrant or the host developed country has an additional obligation to share their benefits in order to compensate for the welfare losses experienced by the developing country. Recent contributions to the literature on the brain drain consist of efforts by economists to identify the nature and composition of the various types of losses associated with skilled migration. Though difficult to quantify, these losses provide an independent basis on which to justify the proposals discussed in this study.

8. The proposals discussed in detail in the body of the study fall into three major categories: (1) Tax incentives to encourage migrants (as well as non-migrants) to make voluntary contributions to special international human resource funds (IHIF) for use in the developing countries; (2) A supplementary tax on PTK income in the developed country of immigration, the revenue from which would be used to augment the net transfer of resources to the developing countries; and (3) An assessment on host developed countries in recognition of the benefits accruing to them from migration. The resources raised thereby being similarly transferred to the developing countries. As will be seen, the proposals are, to some extent, interdependent and are presented as a package. However, each proposal examined is on its own merits and can be adopted separately or in combination with the other proposals.

9. Subsequent sections of this study set forth the legal and administrative difficulties surrounding the implementation of these proposals and discuss their optimal formulation. The remainder of this section briefly summarizes the proposals and provides background information that may help to place the discussion in its proper perspective.

A. Voluntary contributions to international human resource funds (IHFRs)

10. This proposal (discussed in chapter I) can be dealt with briefly here. The suggestion is that tax incentives ought to be provided by the developed countries to enable migrants, their employers, and all other tax payers to make voluntary contributions to recognized organizations or to especially created international human resource funds (IHFRs). If, as is believed, migrants and the firms that employ them are generally willing to make some contribution to the developing countries in recognition of their moral obligations, the level of contribution may be significantly enhanced by such incentives. The assumption is that the tax incentives will induce a response by taxpayers, including non-migrants who have an interest in the developing countries, that exceeds the sacrifice in revenue attributable to the tax incentive. The sacrifice in tax revenue arising from the grant of tax incentives can properly be regarded as a contribution by the developed country. The proposal is particularly attractive since it entails no restriction on migration and is completely voluntary on the part of the donors. In developed countries that already provide tax incentives for charitable contributions within their existing framework, incentives for IHFRs would be a reasonable means of taking into account the special preferences of the immigrant population.

B. A supplementary tax on PTK earnings in host developed countries

11. The second proposal, a supplementary tax on the income of PTKs, was first suggested by Professor Bhagwati in a pioneering article published in 1972. Proceeds from this special tax would be used to augment the net transfer of resources to the developing countries. Legal, constitutional, and administrative issues are comprehensively treated in chapters II, III and the appendix of this study. However, certain aspects of the proposal are dealt with below to clarify any possible misconceptions.

1. Restricted international mobility and its implications for the brain drain

12. Developed countries commonly restrict immigration both quantitatively, through annual quotas, and qualitatively, through various criteria that typically favour skilled over unskilled migrants. Because of these restrictions, the opportunity to migrate is a privilege extended to a favoured minority in the developing country. It seems proper that those who benefit from the

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exercise of this privilege should share part of their gain in order to increase the welfare of those who remain behind in the developing countries. Taxing part of the increased benefits can, in one sense, be viewed as an extension across national frontiers of the principle of progressive taxation. Nor is this a radical innovation in taxation, since it is acceptable under international custom for countries to assert tax jurisdiction over nationals abroad.

13. The restrictions that each developed country imposes on entry may reduce immigration to a level below that which would exist in the absence of all controls, producing an element of "rent" or "surplus" in the income of each skilled migrant. This rent or surplus could be taxed without affecting overall levels of migration. If the rates were chosen carefully, the tax would accordingly have no effect on migration, and this should increase the attractiveness of the proposal.

14. Although overall migration might not be affected, the tax might however reduce the size of the waiting list (i.e., the excess demand) for entry into the developed country. A significant reduction in the size of the waiting list might, inter alia, have the desirable effect of reducing the domestic supply of PTKs with a concomitant savings in education costs and a reduction in salaries.

2. Comparisons with an exit tax

15. It is important to stress that the proposed special tax on skilled migrants is intended as an assessment on their developed country incomes only after migration has taken place. It differs radically from an exit tax, which requires payment of the tax prior to emigration. In a country where the rate of private savings is insignificant, any non-negligible exit tax would be prohibitive, except for individuals having access to foreign capital through personal contacts. Moreover, since an exit tax is a case-for-all levy only, it would involve a lump sum payment of some magnitude which could be discriminatory in its effect. By contrast, the proposed supplementary tax is clearly superior. It would not be a prerequisite of emigration but would be levied annually for a limited duration on the PTKs income in the developed country which could be used to pay the tax. Most important, the proposed tax conforms closely with existing patterns of international taxation.

C. An assessment on developed countries

16. The third proposal, discussed in chapter IV, relates to an assessment on the developed countries of immigration, as opposed to the migrants, in recognition of the benefits accruing to host populations from immigration. The assessment would be based on a formula. In cases where the assessment did not reflect adequately the flow of PTKs between specific pairs of countries, supplementary bilateral agreements could be provided.

D. A sample package

17. The three separate proposals discussed briefly in paragraphs 10 - 16 could ideally be considered as part of a total package combining elements of the three in different proportions reflecting the preferences of the parties concerned. While one party might emphasize changes in developed country tax
laws to encourage voluntary contributions, another might highlight its support for taxing PTKs directly, and still another might give top priority to government payments to international human resource funds (IHRFs) in recognition of the benefits fortuitously received by the developed country as a result of the brain drain. A sample package may thus consist of:

(a) A modest internationally levied brain drain tax, say at a rate between 5 and 10 per cent, levied as a surtax on the tax paid to the developed countries by a defined class of PTKs for a period of not more than 10 years after they first reach levels of income subject to the tax. The period of 10 years is suggested in order, on the one hand, to allow sufficient time for PTKs to reach significant levels of income and, on the other hand, to cut off a PTKs tax liability once a substantial number of years has gone by.

(b) A modest international assessment on each developed country receiving a brain drain flow from the developing countries estimated to exceed a defined and triennially revised floor figure.

(c) The creation of specially chartered organizations - designated as International Human Resource Funds (IHRF) - under developed country and developing country auspices in conformity with a model IHRF to be prepared and continually revised in accord with internationally agreed procedures.

18. The organizational structure of the proposed funds could be designed fairly easily. However, the technical design of both the brain drain tax and the international assessment scheme would require additional legal analysis, further qualitative analysis in measuring and estimating appropriate levels of tax and assessment to achieve desired levels of revenue, and the working out of a host of administrative problems before action could be taken by national and international bodies. The appendix to the present study illustrates some of the problems and their complexity.
Introduction

19. The study is divided into four main chapters. Chapter I examines the main issues involved in instituting a scheme for voluntary contributions to specially created International Human Resource Funds (IHRFs); the proceeds of such funds could be used for financing specified projects in developing countries experiencing the brain drain. The first part of chapter I outlines ways of organizing such a scheme and the possible uses to which the fund's resources may be put. The second part examines the kinds of tax incentives or benefits that may be offered to potential contributors in order to ensure their maximum participation in the proposed scheme. Criteria for eligibility for tax incentives are also discussed.

20. Chapter II analyses various alternative approaches to levying a supplementary tax on the income earned in the developed countries by skilled migrants from the developing countries. Section A provides a brief introduction to international income tax rules, and serves as a background for the subsequent discussion. Sections B and C discuss two possible approaches to applying a supplementary tax on the brain drain: (a) a tax levied by the developing countries and collected by the host developed countries; and (b) a tax levied and collected by the developed countries and channelled to the developing countries. The discussion highlights the legal and administrative problems of implementation.

21. Chapter III examines the possibility and feasibility of introducing an international brain drain tax (IBDT), as a way of avoiding some of the legal and administrative problems discussed in chapter II. In particular, this chapter identifies the role international organizations, such as the United Nations, can play in overcoming these problems and in effectively implementing an IBDT.

22. Chapter IV examines briefly the modalities for levying a special international assessment on host developed countries in recognition of the benefits that these countries derive from the immigration of skilled manpower from the developing countries. This proposal would be the easiest to implement as it would not involve any of the juridical and administrative intricacies that characterize other proposals discussed in the study.

23. Finally, the appendix contains an in-depth analysis of the main structural issues in the design of an international brain drain tax (IBDT).

24. A summary and the main conclusions which emerge from the analysis are presented in paragraphs 4 - 10.
Chapter I

Voluntary contributions to specially created international human resource funds (IHRFs)

25. The proposals discussed in this study would be expected to lead to an increase in the resources available for transfer to the developing countries. These resources could be transferred either to the developing country governments directly or to developing country projects through the disbursements of intermediate organizations, here called International Human Resource Funds. Such Funds may be recipients of voluntary contributions from private individuals or of proceeds raised through taxes or through assessments on the governments of developed countries as later noted in chapters II, III and IV.

A. Organizing and using IHRFs

1. How organized

26. One or more of such Funds might be created in accordance with international practice as organizations with defined powers to receive and spend funds. UNICEF is a prime example of this today. IHRFs might also be created under the laws of any particular regional organizations. The developed countries might create or charter IHRFs. Current examples are the United States and United Kingdom Committees for UNICEF, through which voluntary contributions in those countries are funnelled to UNICEF. Finally, some developing countries might decide to charter IHRFs to attract funds for special projects.

27. The legal characteristics of these organizations constituting IHRFs would vary somewhat depending upon their source of authority, but all of them would have certain basic features in common. They would be exempt from taxes on their receipts, and in many, if not all, cases voluntary contributions made to approved IHRFs would benefit from tax concessions of the sort described in section B of this chapter. An IHRF would have to be non-profit in the sense that its resources could be used only for stated purposes and not for commercial investments. The governing structure of IHRFs would need to be specified in the charters and would be tailored to facilitate decisions in allocating IHRF resources in accord with stated charter purposes.

2. Stated purposes and uses of resources of IHRFs

28. While International Human Resource Funds should be able to allocate their resources to general development purposes or general education purposes, many might prefer specially designed programmes prepared for such Funds. A particular programme might consist of research designed to counter the brain drain itself. Another might focus on training people to develop the capacity to carry out that special research. Resources could also be channelled into programmes aimed at strengthening the domestic technological capability of developing countries or into socially-oriented projects. In any event, it might be desirable to have a multiplicity of Funds and decision-making groups for the formulation of spending programmes.

29. While the present study does not focus attention on the uses of IHRFs, it should be obvious that the success of any means of raising revenues for the Funds will be largely dependent on the articulation of Fund objectives and the manner and degree of their implementation. For example, any one or more of the following may be usefully incorporated in the stated purposes of IHRFs:
(a) To fund specific research and training programmes in developing countries or regions with purposes limited to development of personnel capable of conducting developing-country-oriented technological development;

(b) To fund other specific research and training institutions in developing countries or regions;

(c) To provide general support for research on the development of developing country technologies;

(d) To provide general support for educational institutions in developing countries; and

(e) To receive funds from private voluntary contributors (individuals and juridical persons), from the proceeds of any International Brain Drain Tax discussed in chapter III below, and from proceeds of any assessments levied directly on the governments of the developed countries as discussed in chapter IV below.

30. These purposes are directly related to the principal motivations behind the drive to mitigate the causes and adverse consequences of the brain drain - the moral obligations of PTK migrants and the countries and organizations where and for which they work; the losses suffered by the developing countries; and the need to reduce the brain drain flow by such measures as reorienting research and education in the developing countries.

B. Kinds of tax incentives or benefits for contributors to IHRFs

31. Private individuals and business firms in recognition of the obligations for real economic benefits received from the brain drain flow can be expected to make voluntary contributions to IHRFs designed to achieve agreed purposes. The amounts of these contributions might in turn be significantly enhanced by offering tax advantages to contributors. In so far as these advantages to taxpayers might cause some revenue loss to the developed countries, the estimated amount of such loss might properly be regarded as a contribution by the developed country rather than by the taxpayer. The expectation is that this sacrifice of tax revenue by the developed country will induce contributions by taxpayers which exceed, by more than the sacrifice, the contributions they would have made to IHRFs without the tax incentive. There is no easy way of knowing, however, whether or not the excess will occur or how large it might be. 5/

32. The remainder of this section examines types of tax incentives for contributions and some of the range of existing practices. Studies of existing


1. Tax deductions

33. Individual taxpayers in some developed countries (e.g. the United States, the United Kingdom and the Netherlands) are allowed to deduct from their taxable income the amounts contributed to qualified charitable organizations, subject to a limit, such as 20 per cent or 30 per cent of their income. Amounts contributed in excess of the limit are not deductible from income. The greater the individual's income the higher the rate of tax paid on marginal increments of income under the progressive income tax systems prevailing in developed countries today. Therefore, the greater the income, the larger will be the tax saving realized from the permission to deduct a charitable contribution. Put another way, the greater the taxpayer's income the larger will be the tax inducement to give more to qualified institutions, such as International Human Resource Funds. For those with higher incomes the deduction approach is a stronger tax incentive than the credit approach discussed below.

2. Tax credits

34. A tax incentive may be given in the form of a direct subtraction from income tax otherwise due rather than a subtraction from income before calculating the tax. This form of incentive is usually called a tax credit or simply a credit. The amount might be, for example, 20 per cent of the amount donated to a International Human Resource Fund. For a person in the 20 per cent rate bracket of income taxation, this credit would be equivalent to the tax saved by allowing a deduction from income for the entire amount of a $100 donation. For a person in the 30 per cent bracket, a deduction of $100 would produce a tax benefit of $30, while a tax credit of 20 per cent of the $100 donation would produce a tax benefit of only $20. Tax credits give equal tax benefits to virtually all taxpayers contributing the same amounts. For the same amount donated a tax deduction gives a larger tax benefit to higher income taxpayers than lower income taxpayers; at the same time, the deduction gives more incentive to higher income taxpayers to give larger amounts.

6/ Cahiers de Droit Fiscal International (Studies on International Fiscal Law), Volume 54b: "The possibilities and disadvantages of extending national tax reduction measures, if any, to foreign scientific, educational or charitable institutions".

7/ For example, see INTERPHIL (International Standing Conference on Philanthropy), Draft European Convention on the Tax Treatment in Respect of Certain Non-Profit Organizations, Report presented to the Council of Europe, March 1971, Strasbourg.
3. Combinations of deductions and credits

35. The taxpayer could be given the choice, under specified limitations, of either deducting his donation from his income or of crediting a percentage of his donation against his tax liability. At the present time, the United States gives this option to individuals for donations to political parties or candidates for political office, but the maximum credit is $25 (i.e. 50 per cent of donations up to $50), and the maximum deduction is $100. For any taxpayer whose tax bracket exceeds 25 per cent the deduction may be advantageous if he wishes to give more than $50 for political contributions.

36. An internationally proposed scheme could adopt a carefully chosen set of limits on credits and deductions, giving the taxpayer a choice between deducting or crediting, in an attempt to optimize or in any event increase the amounts donated to IHRFs by persons at all income levels.

4. Business firms

37. A number of business firms, from the large transnational corporations to small professional firms, benefit from employing ITRs and would be willing to make contributions to IHRFs. Such contributions might be induced and increased by allowing deductions or giving credits. The United States allows deductions for contributions to qualified charitable organizations provided the contributions do not exceed 5 per cent of the firm's net income. The Swiss National Government also allows business corporations to deduct small amounts of charitable contributions as business expenses. For some countries it may be expected that business firms could deduct reasonable amounts of contributions to International Human Resource Funds as business expenses in the nature of research and development expenses which may ultimately result in increased business profits.

38. At any rate business firms are a proper focus of attention for the scheme since many of them are direct beneficiaries of brain drain from the developing countries.

5. International civil servants

39. While a number of United Nations or other international employees may feel morally persuaded to make contributions to International Human Resource Funds (witness the Geneva-based United Nations employees' 1 per cent fund for development), the amounts of these contributions might be significantly increased if matched in some way by adjustments in the complex scheme for compensating such employees. For example, if a brain drain tax is adopted and extended to international civil servants, so as to burden their net base salaries, then a credit might be given against this tax for a portion of voluntary contributions made to IHRFs. The credit might range from 20 per cent to 50 per cent of the amount of the donation depending upon the particular employee's "staff assessment".

6. Earmarking

40. The motivation to give larger amounts to IHRFs might well be stimulated by allowing contributors to designate or earmark their contributions for expenditure on certain projects or in certain countries or both. Smaller tax incentives may be needed to induce a given level of donations if the donors have some choice in designating the use of the amounts donated. Some IHRFs
(in UNICEF, for example) might offer a range of project and location choices and even offer opportunities to donors to help design projects. Other Funds might be specialized by country or type of project, so that contributors make their choices by selecting their preferred Fund.

41. Precedent for earmarking of contributions already exists within the United Nations family in the operations of UNICEF. Donors may earmark their donations for particular objectives, projects, and countries on the UNICEF programme agenda.

42. Giving donors an influence over project design and location may offer opportunities for experimentation in dealing with the entire complex of brain drain related problems.

Existing practices in the developed and developing countries

43. As indicated earlier, some surveys of practices with respect to tax incentives for contributions to recognized voluntary funds have been made by private international groups. These surveys need to be examined and extended in order to bring to light the full variety of available techniques in giving tax incentives for charitable contributions as well as the prevailing extent and level of such incentives. For example, the tax provision of the Federal Republic of Germany, which permits churches to have taxpayers who are members of churches pay up to 10 per cent of their income tax liability for the support of religion, needs to be examined as a possible technique to be recommended for use in certain countries. 8/ A developing country suffering substantially from brain drain might find such a technique helpful and adaptable for the provision of sums to an International Human Resource Fund with objectives especially tailored to solving that country's problems.

C. Eligibility for tax incentives

44. One of the potentially more important advantages of the voluntary approach to providing revenue for International Human Resource Funds is that eligibility for the tax incentives for voluntary contributions to such Funds need not be limited to the class of persons designated as PTKs. Any person, organization, or country concerned about or interested in dealing with the brain drain problem could make contributions; and most of them could be eligible for one of the tax incentive allowances. Eligibility may be virtually unlimited as long as organizational design and regulation of IHRFs is adequate to the task of preventing abuses in their spending patterns.

D. The problem of "remittances"

45. A number of persons from the developing countries living in the developed countries or working abroad as international civil servants remit sums to relatives and others on an entirely voluntary basis. Some of these remittances

might be used for solving brain drain problems and might be regarded as satisfying the moral obligations of FTKs or as providing flows of money which in part compensated for losses incurred by the brain drain. Will these remittances be curtailed and shifted to tax-induced donations? Will such shifts be desirable? Can they be detected and measured? Or should it be assumed that such remittances are so highly personal that they are unlikely to be affected substantially by the development of International Human Resource Funds?

46. There are no simple answers to these questions and more research is needed. But it may be worth noting that much of the remittance flow comes from the unskilled group of migrants. While this group is not covered by the present study, it may be safely expected that the proposals discussed here are unlikely to affect the flow of remittances.
Chapter II

Legal and administrative aspects of brain drain taxes

47. This chapter analyses various approaches to levying a supplementary tax on the income earned in the developed countries by individuals who emigrate from the developing countries. Section A provides as a background to the subsequent discussion a brief introduction to international income tax rules. Sections B and C discuss two possible approaches to applying a supplementary tax on the brain drain: a tax levied by the developing country and a tax levied by the developed country. The discussion highlights the legal and administrative problems of implementation.

A. Jurisdictional issues in general

48. Many of the legal issues raised by a brain drain tax are jurisdictional in nature. That is, they involve the rules governing the extent of a country's taxing power. At the outset, therefore, it is important to consider the scope of these powers.

49. In general, countries have exercised self-restraint in asserting their tax jurisdiction. The practicalities of enforcement and the fear that a broad assertion of jurisdiction might offend foreign governments have kept countries from exercising their taxing powers in ways that would create conflicts among countries. Accordingly certain patterns of taxation have evolved that are accepted as a matter of international custom. Some aspects of the brain drain tax, may, however, go beyond existing practice and raise questions concerning the limits of a country's tax jurisdiction. Since the outer limits of a country's jurisdiction are often not clearly defined, only sketchy and tentative answers can be given to some questions at this stage.

50. In order effectively to assert jurisdiction to tax income, a country must rely on some minimum connexion or nexus, between itself and the income being taxed. In terms of this nexus, tax systems can be classified into two major groups: schedular systems and global (or unitary) systems. Under a pure

2/ Many countries are parties to bilateral tax treaties that modify each country's usual pattern of taxation. An objective of these tax treaties is to reach agreement on the acceptable scope of each country's tax jurisdiction. Non-tax conventions can also affect a country's tax jurisdiction in special situations. The International Convention on Diplomatic Relations, for example, provides a tax exemption in the country of employment for income earned by foreign diplomats.


11/ Norr, op. cit. p. 432.
schedular system, the jurisdictional connexion is the sources of the income. Only income from domestic sources is taxed; no jurisdiction is asserted over income from foreign sources. Since all countries tax income from domestic sources, any country that uses a schedular system - that taxes only domestic income - exercises the most limited form of tax jurisdiction. Few countries so restrict themselves.

In a global system, an additional jurisdictional connexion is the personal status of the taxpayer. Jurisdiction is thus based on two independent factors: the source of the income and the status of the taxpayer. Under most global systems, residence is the connexion relied on in asserting tax jurisdiction over individuals. In a few countries, including the United States, Mexico and

12/ Ibid., p. 434.

13/ A country might limit itself to taxing only domestic income if the amount of foreign income were insignificant. Unfortunately, as foreign income becomes increasingly significant, these countries sometimes find themselves locked into their earlier approaches. Other countries may wish to tax foreign income but may not have the administrative capability of enforcing a tax on foreign income. A small number of countries deliberately exempt foreign income to increase their attractiveness as tax havens.

14/ The global approach focuses on an individual's ability-to-pay, as measured by his total income, regardless of its source. Since foreign income increases the individual's ability-to-pay, it would be inconsistent to exempt it from taxation. By comparison the schedular approach focuses on classes of income. Different classes of income (wages, business profits, interest) are commonly taxed at different rates and with different exemptions and deductions. The personal status of the taxpayer is sometimes relevant in determining the rate applied to the income. See, "Schedular and Global Income Taxes", in R.H. Bird and O. Oldman (eds.), Readings on Taxation in Developing Countries, The Johns Hopkins Press, Baltimore, 1967.
the Philippines, citizenship alone is a sufficient connexion. 15/ These countries, however, also tax non-citizens who are residents. That is, either status—citizenship or residence—is sufficient for the assertion of global tax jurisdiction, though the vast majority of taxpayers are both citizens and residents. Countries using a global system tax all income of their citizens and residents, regardless of its geographic source. In other words, income from foreign sources is taxed along with domestic income. The difference between taxing on a residence basis and taxing on a citizenship basis can be illustrated by considering taxpayer A, who is a citizen of country "X". Assume A moves abroad and is no longer considered by X to be a resident. If X taxes on the basis of citizenship, A's change of residence will be irrelevant and X will tax A not only on income earned within X, but also on any income earned abroad. By comparison, if X taxes only on the basis of residence, it will no longer assert jurisdiction over A on the basis of his personal status. Thus X will not tax A on income earned abroad. X will tax A, however, on income received from sources within X. In this case, the source of the income is a sufficient connexion with the country to warrant the assertion of its tax jurisdiction.

52. Most income tax systems are hybrids, employing some combination of the global and schedular concepts. A global system is probably used more often by the developed countries, a schedular system more often by the developing countries.

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Administratively, it is probably more difficult to assert jurisdiction on the basis of citizenship than on the basis of residency. Although the definition of residency varies among countries, a person will normally lose his residence status if he is outside of the country for a prolonged period of time. The longer the individual is out of the country, the more difficult the administrative problems of locating the taxpayer and verifying his income and deductions. Countries taxing on the basis of citizenship must continue to make these efforts, regardless of how long the taxpayer is outside of the country (or regardless of whether the taxpayer has ever been within the country).

The United States is probably more successful in administering its citizenship jurisdiction than other countries would be. Many Americans who work abroad are employed by United States corporations, and this eases the Internal Revenue Service's (IRS) enforcement problems. Moreover, it is more than likely that many Americans alternate periods abroad with periods within the United States. Knowing they are going to return to the United States at some future date helps quench inclinations to ignore United States tax obligations while abroad. Also, the IRS stations personnel abroad as part of its office of International Operations. The IRS's presence abroad undoubtedly encourages taxpayer compliance. Finally, Americans do not easily relinquish their citizenship; thus tax induced renunciations are uncommon. In limited circumstances, tax induced renunciations may be ignored by the United States for purposes of assessing tax liability. (See Internal Revenue Code of 1954, § 877).
The trend in the developing countries, however, is to move toward a more global approach. Few if any developing countries remain which rely on a strictly and narrowly defined schedular approach.

53. To gain a perspective on some of the subsequent presentation, it is useful to realize that countries using a global approach already assert tax jurisdiction over individuals working abroad. Although the primary motivation for adopting the global approach was not to tax the brain drain, these countries already tax PTKs as part of their general assertion of tax jurisdiction over all residents and citizens abroad. Having an existing legal framework for taxing individuals abroad is different, however, from effectively administering such a tax. Most countries find that the problems of enforcing a tax on individuals abroad are considerable. Furthermore, the type of emigrant who comprises the heart of the brain drain may not neatly fall within traditional definitions of residency, or he may think nothing of renouncing his developing country citizenship, thereby raising jurisdictional issues. These problems are explored in section B.

B. Developing country taxation of emigrant PTKs:

1. Jurisdictional issues

54. In order to levy a tax on the part of income earned abroad by an emigrant PTK, the developing country must assert jurisdiction on the basis of the personal status of the PTK. If the developing country relies on residence as its jurisdictional nexus, as do most global type countries, the jurisdictional issue involved in taxing the PTK is the definition of "resident".

55. The definition of "resident" varies markedly from country to country. Some countries follow specific rules that define residence in terms of the period of time a person has been inside or outside the country, thereby avoiding inquiry into less objective factors. Other countries decide the question on an almost ad hoc basis, with little guidance from statutes. Often, a combination of the two approaches is adopted.

16/ As the income tax becomes more significant in the fiscal structure of a country, problems of measuring and comparing individual's abilities-to-pay become increasingly important. Attention logically shifts to a taxpayer's total income, regardless of source. In response to these concerns, a country can be expected to move in the direction of a global system. Pressure to adopt a global system will be increased as foreign investment grows, since a country would want to tap the revenue potential available from taxing foreign income. Moreover, if foreign income were not taxed, investors would have an inducement to invest abroad, aggravating domestic capital shortages.

17/ At one end of the spectrum are countries that define residency in terms that suggest domicile, e.g., a physical presence in the country coupled with an intention to remain for an indefinite period. Once this status has been achieved, it may be difficult for the taxpayer to shed it. At the other end of the spectrum are definitions of residency phrased in terms of business connexion with the country, regardless of whether or not the individual is physically present. A country may have one set of rules for determining when an individual ceases to be a resident. For illustrations of the approaches some countries use, see Harvard Law School International Tax Program, World Tax Series (hereinafter WTS): Taxation in Australia, Little, Brown and Co., Boston, 1958, 5/1; WTS: Taxation in the Federal Republic of Germany, Commerce Clearing House, Inc., Chicago, 1963, 2/2; WTS: Taxation in Sweden, Little, Brown and Co., Boston, 1959, 5/1. The definition of resident for citizens or nationals may be different from that for aliens. See WTS: Taxation in Colombia, Commerce Clearing House, Inc., Chicago, 1964, 11/1.2.
56. Whatever the approach, the basic question is: at what point does a PTK working abroad cease to be a resident of the developing country? The factors that most countries would consider are the intent of the PTK with respect to his being abroad, the length of his stay abroad, and the nature of his contacts with both countries. 18/ For example, a PTK who was sent abroad by his employer for short-term training would clearly remain a resident of the developing country. In contrast, PTKs who have migrated abroad are the least likely to all within the usual concepts of residence.

57. In order to assert jurisdiction over migrant PTKs, the developing country has two options. The first is to define residence in terms of a person's prior contacts with the developing country, even though all these contacts may have been severed long ago. This definition of residence would be broader than that so far adopted by any country. As explained in section A, such a broad assertion of jurisdiction could not be said to violate international law, but because it would be out of the mainstream of international custom and practice, two serious problems could arise. One is that the developed country might refuse to recognize the developing country's definition, especially since it would conflict with the developed country's claim of residence over the PTK. A developed country that viewed the developing country's assertion of jurisdiction as illegitimate would obviously not co-operate with the developing country in policing the tax on PTKs. The other is that the developing country's claim of residence would make little sense to a PTK who had cut all his ties with his country of origin. He might therefore ignore the claim and refuse to comply voluntarily with the tax.

58. In view of the sensitive issues involved, an unorthodox definition of residence is unlikely to sway public opinion in favour of the tax. Indeed, in terms of public acceptance it seems crucial that the supplementary tax conforms as closely as possible to existing patterns of taxation. Therefore, a more fruitful option is for the developing country to follow the pattern established by the United States, Mexico, and the Philippines, and assert jurisdiction on the additional basis of citizenship. 19/ Since these three countries apply citizenship jurisdiction uniformly to all citizens, the developing country could

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18/ Ascertaining residency is often a more difficult inquiry than that of ascertaining citizenship. But enforcing a tax on the basis of citizenship will pose greater problems, since the taxpayer may have little, if any contact with the country.

19/ In some countries, the taxation of the foreign earnings of a non-resident citizen may conflict with constitutional doctrines proscribing legislation having an extra-territorial effect. For example, some Canadian constitutional-law scholars felt that, prior to 1931, Canada was precluded from enacting legislation having an extra-territorial effect. In 1931, the Canadian Parliament acceded to the Statute of Westminster, which expressly authorized such legislation. The Statute of Westminster clearly established the power to tax non-resident citizens on their foreign income, though Canada has never chosen to exercise this power. (See Sherbaniuk, Hutcheon, and Brissenden, op.cit., p. 316).
not limit citizenship jurisdiction to just PTKs without encountering serious problems. The singling out of emigrant PTKs for special treatment, assuming this was consistent with the developing country's domestic law, would raise delicate problems under international law. 20/ These problems, like those arising from an unorthodox definition of residence, 21/ would present obstacles to obtaining the administrative assistance of the developed countries and to obtaining the voluntary compliance of the PTKs. Moreover, other reasons exist for the developing country not to limit its citizenship jurisdiction to PTKs (see B.5 below and section A of the appendix).

59. Unlike an unorthodox definition of residence, the adoption of citizenship jurisdiction is within the mainstream of international custom and practice. Certainly the United States would find it awkward to criticize the developing countries for modelling themselves on its own pattern of taxation, despite the difference in motives. The precedent provided by Mexico and the Philippines should also help to silence public criticism.

2. Renunciation of citizenship by the PTK

60. The developing country's assertion of jurisdiction on the basis of citizenship might induce a PTK to renounce his citizenship in order to avoid developing country taxation. Though one result would be a revenue loss to the developing country, another, more important, consequence would be a lowering of the probability that the PTK would eventually return to the developing country. Imposing an income tax on non-resident citizens might therefore not be in the developing country's best interests to the extent that it resulted in wholesale renunciations of citizenship.

61. Could the developing country ignore a PTK's renunciation of citizenship, at least for the purpose of asserting tax jurisdiction? Again, international law offers little guidance since no country has attempted such a broad assertion of tax jurisdiction. 22/ But two cases can be distinguished. An individual who renounces his citizenship can either acquire a new citizenship or else become stateless. The developing country's assertion of tax jurisdiction over the PTK once he has acquired citizenship in the developed country would raise the same problems as an unorthodox definition of residence. In contrast, any developing country policy that discourages persons from becoming stateless in order to avoid

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20/ The developing countries' domestic law may also prevent the singling out of PTKs for special tax treatment.

21/ An assertion of citizenship jurisdiction by the developing country might also be viewed as creating a conflict between the two countries. The short answer is that countries accept certain conflicts as being legitimate and inevitable. The conflict between citizenship jurisdiction and residence jurisdiction is, by custom and practice considered acceptable. The conflict created by an orthodox definition of resident would, however, not be considered legitimate.

22/ The United States has a provision designed to discourage citizens from giving up their citizenship and moving abroad in order to avoid United States tax. (Internal Revenue Code of 1954, § 877). The special tax imposed on expatriates extends only to their United States investment income and income effectively connected with the conduct of a trade or business within the United States. No attempt is made to tax their foreign earnings that have no connexion with the United States.
taxation would seem reasonable. Thus one approach the developing country could adopt would be to recognize the PTK's renunciation of citizenship only if he obtained a new citizenship. In the case of a PTK who had emigrated to the United States, the developing country could levy its tax for at least five years, which is the length of time an immigrant must normally wait before applying for United States citizenship.

62. If the developing country asserts tax jurisdiction over the PTK during his first five years in the United States, the PTK would have nothing to gain from renouncing his citizenship. From the developing country's point of view, however, limiting taxation to a five-year period may reduce potential revenues. The PTKs early years in a developed country might not be productive in terms of income, especially if he spends part of the time in college. Furthermore, the PTK may be able to reduce his income during this period by working under a deferred compensation agreement.

63. Devising rules to minimize tax avoidance through renunciation of citizenship is difficult, and no one solution appears to be completely satisfactory. This problem might best be handled by an international agency, like the United Nations, for example as possibly the most appropriate body to develop rules for taxing PTKs who have surrendered their citizenship.

64. The problem of wholesale renunciations may, however, prove to be a largely academic one. A supplementary developing country tax that imposes only a modest burden on the PTK is not likely to result in renunciation. Renunciation would also be unattractive to a PTK who wished to retain close family links with his country of origin, or to a PTK who was uncertain about his future plans. Moreover, cultural and social patterns are likely to influence a PTK's decision; the strength of his ties to the developing country might outweigh the tax savings from renunciation.

3. Relief from double taxation

65. International double taxation can result when a taxpayer or his income has jurisdictional connexions with more than one country. Since a developed country will tax a PTK on income earned within the country, double taxation will occur if the developing country also taxes the PTK.


24/ Such an approach would be similar to the United States Common Law rule that a person does not lose one domicile until he has acquired another.

25/ Under certain conditions (e.g. marriage to an American citizen), the waiting period may be less than five years.

Professor Bhaguati suggests that the tax be converted into a capitalized sum at the time of a change in nationality. It is, however, questionable whether the United States could constitutionally help the developing country collect this sum. See footnote 41 below.

26/ International double taxation commonly arises when one country taxes an individual on the basis of residency or citizenship and another country taxes the individual on the basis of the source of the income. Double taxation can also arise if two or more countries consider the taxpayer as their resident or national, or consider the source of the same item of income as being within each of their territories.
66. Suppose a PTK has taxable income of US $20,000 derived entirely from employment within the United States. Assume that the United States tax would be levied at an effective rate of 25 per cent, resulting in a United States tax liability of US $5,000. If the developing country levies its regular income tax on the same base, US $20,000, at an effective rate of 45 per cent, the developing country tax liability would be US $9,000. The total tax burden on the PTK's earnings would be US $14,000 (US $5,000 plus US $9,000), for an overall effective rate of 70 per cent.

67. As the example illustrates, the burden of double taxation can be quite onerous. Most countries that tax foreign income therefore use some type of foreign tax credit mechanism to provide relief. Among the countries using the credit method described below are: Canada, Greece, The Federal Republic of Germany, India, Israel, Japan, Mexico, Pakistan, the Philippines, Turkey, the United Kingdom and the United States. Other countries may agree to grant a credit for taxes paid to countries with which they have tax treaties. The United States, for example, requires its tax treaty partners to grant a credit to their residents for income tax paid to the United States.

68. A foreign tax credit is a unilateral method of eliminating double taxation by allowing the country of source the prior claim on the income. In its simplest form, a credit mechanism would require that the taxpayer compute his tax liability and then take as a credit against that liability the amount of any foreign tax paid on the income. The PTK in the example would take a credit for the United States (the country of source) tax of US $5,000, thereby lowering his developing country tax liability from US $9,000 to US $4,000. From the United States point of view, the PTK has no foreign income and thus cannot take a credit against his United States tax liability. In other words, from the United States point of view, the developing country has no prior claim on the PTK's income since the developing country is not the country of source. The final result is that the PTK pays tax to the United States at a rate of 25 per cent and to the developing country at a rate of 20 per cent.

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27/ The developing country will determine the PTK's taxable income according to its own definition. This determination of the PTK's taxable income does not have to correspond with that of the United States.

28/ Other methods of eliminating or reducing double taxation include granting an exemption for all foreign source income (or perhaps limiting the exemption only in cases where the foreign income was subject to a foreign tax), granting a deduction for foreign taxes, or applying a reduced rate of tax to foreign income.

29/ The text greatly simplifies the credit device. Questions that must be answered in designing a credit device include: What types of foreign taxes are creditable? What kinds of limitations are needed to prevent the foreign tax credit from reducing the country of residence's tax on domestic income? How should double taxation be defined? How should foreign income be defined? The United States has developed a sophisticated set of rules that govern the use of its foreign tax credit. See, Elisabeth Owens, The Foreign Tax Credit (Cambridge, MA: Harvard Law School, International Tax Program, 1961).
69. In short, as long as the developing country tax rate is higher than the United States rate, the credit results in tax being paid to the developing country at a rate equal to the excess of the effective developing country rate over the effective United States rate (the 20 per cent final result in the example). As long as the PTK's earnings are high by developing country standards, the effective developing country tax rate will probably exceed the effective United States rate, and it will therefore receive some tax revenue from the PTK. Should the United States rate be higher than the developing country rate, however, the credit for taxes paid to the United States will exceed and thus cancel the developing country tax liability. If the rates in the example were reversed, the PTK would pay US $9,000 in United States tax, and credit this foreign tax against his developing country liability of US $5,000. Under these circumstances, the developing country would receive no tax revenue from the PTK.

70. If the United States wished to increase unilaterally the amount of revenue collected by the developing country, it could deviate from longstanding practice and grant a credit for the developing country tax. In the preceding example where the United States tax was initially US $5,000 and the developing country tax was US $9,000, a credit for the developing country tax would eliminate the United States tax liability and the developing country would collect the full US $9,000. The credit would thus have the effect of transferring US $5,000 from the United States to the developing country. Where the rates were reversed, and the PTK had an initial United States tax liability of US $9,000 and an initial developing country tax liability of US $5,000, a credit for the developing country tax would reduce the PTK's United States liability to US $4,000 and would allow the developing country to collect its tax liability of US $5,000 without increasing the overall tax burden on the PTK. Again, the credit would have the effect of transferring US $5,000 from the United States to the developing country. Granting a credit for a developing country tax levied on income whose source was within the United States would logically have nothing to do with a rational policy of relieving double taxation and could be viewed as simply a means of transferring revenue to the developing country; in other words, a foreign aid programme carried out through a technical change in the rules governing the foreign tax credit. Using the foreign tax credit for channelling foreign aid may not be unprecedented, however. During the 1950s, the United States Treasury Department took the position that levies imposed on United States oil producers by the Arab oil producing countries were taxes rather than royalties. By characterizing the levies as taxes, which could be credited against United States taxes, rather than as royalties, which could only be deducted as a business expense, the result was to transfer tax revenue from the United States to the oil producing countries without increasing the overall tax liability on the producers. Critics argue that the levies were properly royalties but were incorrectly characterized as taxes in order to aid the oil producing countries at a time when more explicit forms of foreign aid would have been unacceptable. The royalty versus tax issue is currently under re-examination in the United States.

71. If the goal of the developing countries is to maximize revenue, they have the option of not allowing a credit for foreign taxes. Moreover, no principle of international law requires a country to provide relief from the burden of double taxation. 30/ Indeed, if a developing country wanted to increase the economic cost of the PTK's decision to work abroad, it would adopt no relief provisions whatsoever. The lack of any relief provisions might, however, be counter-productive in a revenue sense, because it would encourage the PTK to evade or avoid the developing country tax.

30/ Worr, op. cit., p. 438.
72. In deciding whether or not to adopt some method of relief, the developing country has to consider the attitude of the host developed country, especially if it will need assistance from the developed country in enforcing its tax. The United States, Canada, the United Kingdom and the Federal Republic of Germany, all of which use the foreign tax credit as a means of relief, might not be willing to help enforce a tax whose burden they deemed excessive. If the developed countries were sensitive to the effect of the developing country tax on emigration, the best course for the developing country might be to adopt some method of relief as a precondition to requesting administrative assistance from the developed countries.

73. The credit mechanism eliminates only the burden resulting from double taxation. As the effective developing country rate in the example (45 per cent) indicates, the PTK's income in the developed country makes him appear quite affluent by standards in the developing country. A salary that is considered to be no more than adequate by United States standards may well thrust the PTK into the developing country's upper tax brackets and a developing country income tax that would be appropriate if the PTK were living in the country could border on being confiscatory when measured against the cost of living in the developed country. Thus the relief afforded by the credit mechanism might not be sufficient. Instead, the developing country might consider adopting a special rate structure for taxing foreign income. (See B.5, below and Part C of the appendix.)

4. Tax base

74. The example used to illustrate the workings of the tax credit mechanism assumed that the PTK's tax base, that is, his taxable income, was the same under both the developing country and United States law. But the developing country will normally determine the PTK's tax base under its domestic law. And just as the developing country's usual rate schedule may produce unsatisfactory results when applied to a PTK working abroad, it may not be possible simply to apply the developing country's normal rules and principles governing income, deductions, capital allowances, exemptions, and so forth to a PTK working abroad. Rules that work reasonably well in the developing country may be totally inappropriate or have unintended consequences when applied to unfamiliar transactions and business practices in the developed country. These issues are pursued in greater detail in the appendix.

31/ The extension of a country's tax system to foreign income can be defended on grounds of tax neutrality, which requires that a country tax foreign income in the same manner as domestic income (with a credit for foreign taxes). Decisions whether to invest abroad rather than domestically will thus be unaffected by domestic tax considerations resulting in the efficient international allocation of capital. It is tempting to extrapolate from this case and argue that the extension of the developing country tax system to PTKs abroad maintains tax neutrality and economic efficiency. When a taxpayer resides abroad, however, the principle of neutrality would tend to break down since the developing country tax rate schedules are designed in the context of the developing country's cost of living, salary levels, and income distribution. As the example in the text suggests, the developing country rates may become confiscatory when applied to a PTK in the developed country unless, of course, combined with relief for double taxation.
75. An entirely different approach, discussed in the following section, is for the developing country to use the developed country's tax base. 32/

5. Rates of tax levied by a developing country

76. The amount of developing country tax liability has a strong bearing on taxpayer compliance, as well as on many of the other problems discussed above. Although some PTKs may not co-operate with the developing country under any circumstances, the behaviour of most will be influenced by the size of the developing country's supplementary tax on their foreign earnings. If the burden is not unreasonable, the PTK will be less likely to renounce his citizenship or use other means of evading or avoiding the tax. Furthermore, the developed country may be more likely to assist the developing country in collecting the tax if the rate is low enough not to influence the PTK's decision to emigrate or constitute a hardship while he is living in the developed country. Thus considerable thought must be given to designing the developing country rate structure.

77. The appendix provides a detailed discussion of the approaches available in designing a rate schedule applicable to taxpayers abroad. One approach would be to ignore the PTK's presence abroad and apply the developing country's normal, domestic tax rates. As was illustrated above, this approach is likely to lead to an overall tax burden on the PTK that may be onerous by developed country standards, even if relief is provided through a credit for taxes paid in the developed countries.

78. A second approach would be to design a special rate schedule applicable only to PTKs abroad. Ideally, this special schedule should take into account the PTK's tax liability in the developed country; therefore, a separate set of rates would have to be developed for each developed country.

79. The most promising approach would seem to be for the developing country to levy a surtax on the amount of the PTK's tax liability in the developed country. Under this approach, the PTK would calculate his developed country tax liability in the usual way. To calculate his developing country tax, the PTK would multiply his developed country liability by the amount of the surtax. If the developed country tax liability were US $1,000 and the rate of the surtax were 10 per cent, the developing country tax would be US $100 (US $1,000 x 10 per cent).

80. The surtax may appear initially to be only a variation of the second approach, whereby a separate rate schedule is designed for each developed country. But the surtax differs in a major respect. The separate rate schedules designed under the second approach would apply to the PTK's tax base as determined under the developing country law. The surtax, however, is a function of the developed country tax, which in turn is dependent on the developed country rules and principles governing the calculation of the tax base. While the surtax approach may work satisfactorily with some, if not most PTKs, special cases could pose difficulties. (See Part B.1 of the appendix.)

32/ Not all developing countries use an income tax. Using the developed country's tax base would be especially attractive for these developing countries, since it avoids the necessity of designing their own tax base.
6. **Administrative considerations**

81. Policing a tax on residents and citizens living abroad creates problems even for a sophisticated tax administration such as that of the United States. Since many developing countries lack an effective tax collection machinery, the assertion of citizenship jurisdiction may cause severe enforcement problems. In countries plagued by low taxpayer morality and lacking experience in the taxation of foreign income, the problems will be compounded.

82. A developing country using a pure schedular-type system will have had no experience in taxing foreign income. Furthermore, the reason the country uses a schedular-type system and taxes only domestic income may be that its tax administration is not capable of administering a global system. A developing country using a global-type system, however, will have had some experience in taxing the foreign income of its residents. Despite this experience, it will find it harder to enforce a tax on the foreign income of emigrant TPKs than on that of residents.

83. The willingness of TPKs to comply with the tax laws of their countries will depend on the loyalties that they feel. On the one hand, some TPKs may feel a deep moral obligation to repay the developing country for the educational or other opportunities afforded them. On the other hand, TPKs may constitute a most recalcitrant group of tax payers. Some may fail to see the equity aspect in a tax burden that exceeds that of their colleagues in the developed country. Others, whose primary motive for leaving the developing country was to escape political, religious or social oppression may have no intention of contributing to the costs of a government or society with whose policies they disagree. Those forced to emigrate as a result of the lack of professional opportunities in the developing country may also be opposed. Secure in the belief that the developing country does not have easy access to their financial affairs in the developed country, certain TPKs may feel confident to file a tax return containing false information. Indeed, a TPK who has cut all ties with his country of origin may see no need to file a return at all. 33/ Obtaining accurate information about a TPK's taxable income is the first problem a developing country faces in administering a tax on non-residents. Once the TPK's tax liability has been determined, the second problem lies in collecting the amount owed.

84. In order to obtain the information necessary to access a recalcitrant TPK, the developing country may engage in some form of unilateral action. For example, a developing country tax administrator could go to the developed country and conduct his own investigation. This approach is obviously expensive; moreover, the developed country may regard the tax administrator's presence as an intrusion on its national sovereignty. For these reasons, unilateral action is rarely used unless large amounts of revenue are involved. 34/


34/ **Ibid.,** p. 182. International law may prohibit a country from exerting any administrative activities within another country without special permission. See A. Radler, Corporate Taxation in the Common Market, Part IV, in Guides to European Taxation, Vol. II, (mimeograph), Amsterdam, p. IV-A:5.
85. A more effective and less expensive approach open to the developing country is to enlist the co-operation of the developed country's tax administration. If the desired information is not already available, it will be easier for the developed country's tax administration to make the appropriate investigation than for the developing country's. Furthermore, the PTK's knowledge that the developing country can readily obtain the relevant information will encourage him to comply with the tax laws of his country by filing an accurate return in the first place.

86. The United States, like most developed countries, does not exchange tax information on an informal basis. Information is exchanged only under conditions specified in a tax treaty. The actual information exchanged varies from treaty to treaty. Certain readily available information, such as a list of foreign taxpayers receiving investment income from which United States taxes have been withheld, may be routinely exchanged, especially if such information has already been compiled for United States tax purposes. Non-routine information, for example, information on a specific taxpayer, must be specially requested by a foreign government and usually will be supplied only in certain limited circumstances. In practice, the number of individuals about whom information is exchanged is not large. 35/

87. Once the PTK's tax liability has been assessed, the developing country is faced with the problem of collecting the tax owed. The problem may be simplified if the PTK has assets within his country of origin held as security against his tax liability. But if the PTK has removed all his assets to the developed country, the developing country has four options. It may (i) ignore the tax owed until the PTK returns, if ever; (ii) use non-tax measures as leverage to encourage payment of the tax; (iii) collect the tax through the developed country's courts; or (iv) have an administrative assistance agreement with the developed country.

88. The first option provides the PTK with an obvious disincentive to return to his country. Even if the PTK were to return, his accumulated tax bill might outstrip his financial resources. This option also has the disadvantage of putting the PTK in the position of being able to negotiate for a lower tax liability as a condition of his returning.

89. The effectiveness of the second option depends on what measures for applying pressure on the PTK are available to the developing country. For example, the PTK may have to ask the developing country to renew his passport or his medical or engineering licence, and the developing country can refuse to co-operate unless the PTK's tax liability has been satisfied. 36/

90. The third option may not be available to all developed countries. The British, Canadian and American courts, 37/ for example, may not recognize a foreign tax judgement, apparently on the theory that a tax is an assertion of a foreign country's sovereignty which another independent country could not admit within its borders. A similar argument is sometimes made that taxes are closely connected


with public policy and foreign relations; by ruling on the validity of foreign taxes, the judiciary might embarrass its own country or the foreign country. 39/

91. The fourth option, engaging the assistance of the developed country's tax administration, is the most effective one. Since the developed country has jurisdiction both over the PTK and over his assets within the country, it is obviously in a position to bring to bear the full weight of its own collection machinery. A tax administration that is asked to provide collection assistance may either (i) refuse all collection assistance; (ii) provide some collection assistance informally; or (iii) agree to undertake collection assistance only in accordance with a formal commitment.

92. Several tax administrations have refused to engage in intergovernmental tax collection assistance of any kind. 39/ A country that feels it would gain very little through such co-operation will not wish to expend its limited administrative personnel in collecting taxes on behalf of a foreign country. 40/ Other tax administrations may, under certain circumstances, informally help another country collect its taxes. If a PTK does not dispute the amount of developing country tax assessed, a developed country tax administration might send him a letter demanding that he pay the amount owed. This apparent joining of forces by the developing and the developed countries could be enough to frighten the taxpayer into paying, even if neither the tax administration nor the courts were to take any action if the PTK ignored the letter.

93. The United States does not engage in collection assistance on an informal basis. Any collection assistance offered by the United States - or, for that matter, by most Western European countries - is in pursuance of a formal commitment contained in a tax treaty. 41/ Most treaties have explicit provisions pledging each country's assistance to the other in the collection of taxes, but assistance is usually limited to situations in which taxpayers wrongfully seek

39/ Surr, op. cit. p. 222. For criticism of this doctrine, see Lawrence Robertson, "Extraterritorial Enforcement of Tax Obligations", Arizona Law Review, Vol. 7, 1966, p. 219. Although the United States courts will not enforce foreign tax judgements, they will, under certain conditions, enforce non-tax judgements. The United States court must be convinced (1) that the foreign court had proper jurisdiction to issue the judgement; (2) that a fair trial was conducted under a system of jurisprudence likely to secure an impartial administration of justice; (3) that the judgement was not procured by fraud; and (4) that the underlying cause of action is not contrary to the public policy of the United States. See American Law Institute, Restatement of the Law, Second: Conflict of Laws, American Law Institute Publishers, St. Paul, Minn., 1971, § 98; see also Monrad Paulsen and Michael Sovern, "Public Policy" in the Conflict of Laws, Columbia Law Review, Vol. 56, 1956, p. 969.

40/ This feeling was also echoed in recent conversations between the authors of this study and officials of the United States Internal Revenue Service.

41/ Historically, the United States has not entered into collection agreements, or exchange of information agreements, independently of a tax treaty.
to obtain treaty benefits. 42/ The case of a PTK who has failed to pay taxes to a developing country does not constitute such a situation. Only one recent United States treaty provides for assistance under more general circumstances. 43/

94. The use of collection assistance agreements is a relatively undeveloped area. Over and above taxpayer resistance to such provisions, which is undoubtedly an obstacle to their adoption, 44/ difficult policy questions must also be resolved. For example, under what conditions can one country refuse to assist the other in the collection of taxes? If a developing country levies a tax only on non-residents who are PTKs, and if a similar tax would be unconstitutional if enacted by the United States, should the United States nonetheless provide collection assistance to the developing country? How can the taxpayer be protected against arbitrary conduct by the taxing country? The lack of agreement on these issues has hindered intergovernmental co-operation in the collection of taxes.

95. As this brief survey of existing practices indicates, some precedent does exist for international co-operation in the exchange of tax information and, to a much less extent, in the collection of foreign taxes. The limited amount of co-operation now being offered, however, would clearly be inadequate if more than just a few PTKs failed to comply with the developing country tax laws.

96. Assuming a developed country was willing to offer broader assistance than usual, it might not do so without the assurance that other developed countries were similarly inclined. Otherwise, any developed country that was competing with other developed countries for special types of PTKs, such as doctors, might fear that its enforcement efforts would only divert immigration to those countries not willing to offer the same assistance. Whether all the developed countries could come to an agreement on the appropriate amount of assistance without detailed international negotiations in a forum such as the United Nations, is doubtful.

7. A synthesis

97. A developing country tax on residents and citizens working abroad would be compatible with existing jurisdictional concepts of taxation. The legal structure therefore exists for a developing country to levy a tax on the brain drain. The problem of administration is to evaluate whether or not the developing countries can achieve the level of enforcement necessary to implement the tax. The factors to be considered in making this evaluation are: (a) the over-all efficiency of the developing countries' tax administration; (b) the developing countries' prior experience with taxing foreign income; (c) the existing level of taxpayer morality; (d) the social and economic conditions that generated PTK emigration; (e) the developing countries' access to the assets of

42/ E.g. "Each of the Contracting States shall endeavour to collect such taxes imposed by the other Contracting State as will ensure that any exemption or reduced rate of tax granted under this Convention by that other Contracting State shall not be enjoyed by persons not entitled to such benefits." Article 27, United States-Japan Tax Treaty.

43/ "The two Contracting States undertake to lend assistance and support to each other in the collection of the taxes to which the present Convention relates ... in cases where the taxes are definitely due according to the laws of the State making the application." Article 27, United States-France Tax Treaty.

emigrant PTKs; (f) possible renunciation of citizenship by PTKs in order to avoid the tax; and (g) the host developed country's attitude toward assisting in the collection of foreign taxes. Most developing countries will require substantial assistance from the host developed countries in administering the tax; yet little precedent exists so far for such widespread intergovernmental co-operation, although there seems to be scope for doing so through a process of internationally conducted negotiations.

C. Taxation of PTKs by the developed countries

98. The alternative to a developing country tax is for the host developed country to levy a special tax on PTKs. The tax could be collected as part of the developed country's usual procedures but would be separate from the tax revenue that would otherwise go to the developed country's treasury.

99. In the case of the United States, a special tax on PTKs might raise serious constitutional problems. Even if the legality of a United States tax on PTKs were beyond question it is doubtful whether Congress would enact such a tax. Furthermore, it is hard to imagine other developed countries adopting the tax. It is also easy to overstate the administrative simplicity of collecting a developed country levied tax on PTKs. There may be a number of problems involved in actually administering such a proposal.

Chapter III

An international brain drain tax (IBDT): some considerations

100. Many of the issues raised in the preceding sections could best be resolved in the institutional framework provided by an international organization, such as the United Nations system. This part, therefore, attempts to identify the role an international organization, such as the United Nations could play in overcoming these problems and in effectively implementing an international brain drain tax (IBDT). No other forum provides a mechanism for balancing the diverse interests of the developing countries, the developed countries and the PTKs and for reconciling possible conflicts between the revenue raising brain drain proposals and international law. In view of the serious administrative and enforcement problems encountered by a developing country acting unilaterally, effective implementation of the proposal is likely to occur only under the auspices of an international organization.

101. Participation by the United Nations system could take a number of forms. As a start, developing countries could be informed about their authority under accepted international custom to levy a special tax on their residents and nationals abroad. The United Nations could sponsor research distilling and analysing the experiences of the United States, Mexico, the Philippines, and other countries that tax on the basis of citizenship. The research could serve as the basis on which to provide technical expertise necessary in overcoming the problems discussed above. Just as important, the United Nations could provide a forum through which the host developed countries could co-operate in helping to enforce the developing country tax. It could also play a more active role in order to assure the widespread adoption of an international brain drain tax (IBDT) by rendering assistance in designing, implementing and adopting the IBDT, rather than leaving it to the initiative of the individual countries. Without the active support of the international community, through such a body as the United Nations, fears of adverse reaction might make individual developed countries wary of co-operating unilaterally with the developing countries.

102. What forms might the IBDT take? If it were desirable for the IBDT to conform as closely as possible to existing patterns of taxation, the IBDT could be presented as a way of assisting the developing countries in exercising their rights to assert tax jurisdiction on the basis of citizenship. Under this version, the IBDT would be seen as a simple extension of each developing country's domestic tax system to PTKs abroad, thus allaying fears of a new internationally levied global tax. The primary role of an international organization, like the United Nations, could be that of a catalyst, establishing a dialogue between the parties and providing assistance in overcoming technical and legal obstacles. Viewed in this manner, there would not formally be "an IBDT" as such, but rather the assertion by each developing country of tax jurisdiction on the basis of citizenship, accompanied by the increased co-operation of the developed country tax administrations in enforcing the developing country tax.

103. Support for this version of the IBDT might come not only from those who saw it as a reasonable response to the problems of the brain drain, but also from those who viewed it as a worthwhile change in tax policy for other reasons. In fact, the proposal could be treated as a technical change in international tax practice, thus laying less emphasis on its origins as a response to the brain drain. For example, the proposal could be presented in the form of a multilateral convention on the enforcement and collection of foreign taxes.
104. However presented, there may be little enthusiasm for enforcing a developing country tax if the PTK's migration was in response to religious or political oppression, or harsh social conditions. Even vigorous advocates of a PTK's moral duty to share his increased benefits with those left behind in the developing country might be troubled by funds being transferred in such cases. Dealing with this problem raises sensitive political problems. An exemption for political, and similarly situated, refugees would seem attractive, and the administrative modalities for operating such exemptions would have to be carefully considered.

105. A more fruitful approach might be to distribute the IBDT revenue using other criteria. An obvious one is to distribute the funds on the basis of need. "Need" can, of course, be measured in many different ways and different indices are likely to lead to a different ranking of developing countries (though some developing countries will appear relatively rich or relatively poor regardless of the indices chosen).

106. Developing countries receiving funds on the basis of need, however, will not necessarily be those countries experiencing a brain drain. If the relationship between need and the brain drain becomes too attenuated, the brain drain proposals might come to be seen as a foreign aid programme. Should the debate over the proposals become a debate over foreign aid, the persuasive value of the unique moral and economic underpinnings of the proposals will be diminished.

107. Because of these considerations, many developing countries, PTKs and developed countries might prefer a scheme that earmarks the revenue generated by the IBDT for spending on brain drain (or education) oriented projects, similar to the IHRFs proposed with respect to the charitable contribution. Transferring revenue to the IHRFs created for charitable contributions, or to specially created IBDT IHRFs will distinguish the brain drain proposals from a more general foreign aid programme and should appeal both to persons who want to use the funds to compensate the developing countries for their losses and to persons who view the brain drain proposals as a means of redistributing income and wealth. PTKs may also be more likely to favour a programme that was project-oriented rather than country-oriented. These options are, however, not mutually exclusive. Part of the brain drain revenue could be allocated on a country-by-country basis, taking into account both "need" as well as PTK emigration. Part of this allocation could, in turn, be earmarked for specific projects with the remainder left unrestricted. The revenue that was not allocated on a country basis could be earmarked for specific projects or specific countries or both.

108. Once the simple connexion between the PTK and the country receiving the revenue has been broken, there would be no logically compelling reason to view the tax as simply an extension of the developing countries' tax jurisdiction to nationals abroad. The supplementary tax could then be treated as a truly international brain drain tax, and the international community would be free to decide through negotiations how best to design the IBDT. The appendix pursues some of the structural decisions that have to be made. It is useful, however, to present at least one version of the IBDT to illustrate how it might be implemented. For illustrative purposes, therefore, assume that the IBDT is levied as a surtax on the PTK's tax liability in the developed country, an approach that presents fewer problems than do the alternatives discussed in the appendix.

109. At a first glance, a surtax appears simple to administer since it is based on the developed country tax. One would suspect that it could be easily implemented by simply adding a line to the existing developed country tax
This administrative simplicity is deceptive, however; in many respects, administering a surtax applicable only to some developed country taxpayers, that is, only to PTKs, rather than to all taxpayers is equivalent to the adoption of an entirely separate tax. The administration must (i) modify or prepare special tax forms; (ii) compile and update the roll of taxpayers subject to the tax; (iii) design special withholding tables and instructions; (iv) develop current payment programmes for the self-employed and other taxpayers not subject to withholding; (v) plan taxpayer information programmes including the preparation of descriptive pamphlets and mass education programmes concerning filing requirements; (vi) write regulations and rulings that interpret the statute; and (vii) train officials to answer questions from taxpayers and to deal with disputes on appeal. Most of these problems are manageable, but must be thought through in a new context.

As an example, consider the need of establishing and maintaining the tax roll. Some means must be developed so that both the tax administration and withholding agents or other payers can easily identify individuals subject to the IBDT. One way of building the required tax roll would be to obtain the relevant information from the immigration authorities. If the IBDT were levied on all developing country migrants, it should not be a major problem for the immigration bureaux to produce a list of newly entering individuals subject to the tax. If, however, the IBDT were levied, not on all developing country migrants but only on certain categories of professionals, it might be far more difficult for the immigration authority to verify the status of each immigrant. (See part A of the appendix.)

If the tax administration is capable of identifying the PTKs, it would be able to send each of them information on their special tax obligations. A PTK could also be required to inform his employer of his status for withholding purposes.

As this brief description of just one aspect of the administrative problem illustrates, the IBDT would require some changes in present developed country practices and co-operation from the developed countries in enforcing the IBDT with the requisite degree of vigilance.

The collection of taxes by one level of the government for the benefit of another is called "piggybacking". Provisions exist in the United States allowing the Internal Revenue Service to collect a state's income tax as part of its collection of the federal income tax. Due to administrative considerations, a condition for using the "piggybacking" provisions is that the state's income tax base conforms closely to the federal tax base, although some differences are tolerated. These "piggybacking" provisions could be expanded to cover the IBDT and perhaps include the types of adjustments to the tax base discussed in Part B.1 of the appendix. The IRS proposed regulations for state piggybacking may be found at 42 Federal Register 5 1790, 29 September, 1977.
Chapter IV

International assessment on host developed countries

113. A particularly important proposal that has received much attention in recent debates on the brain drain concerns the levying of a special assessment on host developed countries in recognition of the benefits that these countries derive from the immigration of skilled manpower from the developing countries. The rationale behind such a proposal has been rigorously advanced and discussed in the accompanying study prepared for the UNCTAD secretariat by Jagdish N. Bhagwati. 47/ Suffice it to say here that the assessment would recognize and help share the extent to which the developed countries were enriched by the immigration of persons whose talents are in short supply in all countries and would help to share this out. The proceeds from the assessment would provide an additional source of revenue for the internationally sponsored Human Resource Funds.

114. The concept itself is not a new one and would simply involve the use of existing procedures which implement the provisions of the Charter of the United Nations on assessments through the enactment of a resolution.

115. The assessment could be designed to take into account a number of variables. For example, the assessment could be a function of the total number of PTKs who immigrated to the developed country, the amount of their income, the amount of tax they paid to the developed country or the amount of their IBDT, the relative scarcity of their skills in their developing country of origin, the amount of education they received at developing country expense, or any other combination of factors that would generally reflect the costs and problems of specific developing countries as well as the enrichment of the developed countries. 48/

116. In cases where the assessment on host developed countries did not reflect adequately the flow of PTKs between specific pairs of countries, bilateral agreements could provide for additional transfers of funds. These supplementary agreements could provide for additional transfers of funds. They would recognize the special conditions existing between countries, or would adjust for unique flows of PTKs among contiguous countries. International organizations, such as the United Nations, can encourage the use of supplementary agreements by providing the necessary technical assistance, statistical information, and moral suasion.


48/ If the assessment were substantial, developed countries might be encouraged to reduce levels of PTK immigration. Some constraints are therefore imposed on the amount of the assessment.
117. The administrative problems posed by an assessment on host developed
countries are modest in comparison with those encountered in levying a special
international tax on individuals. As an illustration, consider an assessment
based only on the income earned by the total group of skilled migrants in a host
developed country. To compute the assessment only aggregate data is needed; such
information can be obtained from sample surveys and cross-sectional studies. Some
of these studies have already been prepared by economists concerned with measuring
the brain drain. It is far easier to update these studies periodically, even if
variables other than income were involved, than it is to assess and collect a tax
annually from individual skilled migrants. Because the assessment is levied on
the host developed country and not on the individual migrants, many of the problems
discussed in chapters II and III become either irrelevant or of little
significance. On the other hand, it should be underlined that an issue of such
major significance will require the search for solutions to proceed along a number
of lines in order to achieve the best possible mix.
Structural issues in the design of an international brain drain tax (IBDT)

1. This appendix discusses three major structural issues in the design of an international brain drain tax (IBDT): defining the class of taxpayers subject to the tax; choosing the rules and principles to govern the calculation of the tax base; and selecting an appropriate set of tax rates. The selection of these topics is by no means exhaustive. At this point in the evolution of the brain drain proposals, it does not appear necessary to treat exhaustively and rigorously the range of issues raised by the IBDT. The appendix sketches the broad outlines of the IBDT, in order to provide a framework in which rational debate may proceed.

A. Defining the taxpayer

2. As originally conceived, the proposals to tax the brain drain were intended to apply to professionals, such as scientists, doctors, and engineers. Throughout this study, "PTK" has been used to indicate generally this group of professionals who are viewed as comprising the heart of the brain drain problem for most developing countries. A precise definition would be necessary, however, if the term were used to define those individuals who were to be subject to the IBDT.

3. Any attempt to define PTK faces serious obstacles. Aliens are present in the developed countries for a multitude of reasons: some come on short business trips, others stay for a few years to teach, and still others may come as students and stay after completing their education. Skills and jobs also come in many packages and do not always fit easily in defined pigeonholes. Lawyers, international civil servants, businessmen and others may have a good deal of flexibility in describing their jobs or skills. Since skills and jobs, as well as reasons for being in the developed country, will vary from year to year, it would not be sufficient to determine an alien's status for purposes of the IBDT only at the time of immigration; this would have to be done annually.

4. The variety of situations encountered poses a challenge in drafting a workable definition of PTK. Fine distinctions are likely to be drawn, and considerable strain would be placed on any definition by taxpayer manoeuvres to circumvent it. Any weakness in the definition would operate to the advantage of the taxpayer.

5. The alternative to defining PTK would be to include in the scheme all of the developing countries' residents and citizens in the host developed country. a/

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a/ In order to avoid difficult determinations of residency, the IBDT might be applied only to developing country nationals. In many cases, the PTK will be both a resident and a national of the same developing country and it will be irrelevant whether the residency test is applied. A difference could result, however, in the case of some developing countries, such as the United Kingdom's former colonies in Africa, where the brain drain may consist of PTKs holding developed country citizenship. If desirable, immigration authorities in the developed country could identify these cases and the determination of residency could then be made by the tax administration.

In any case, special rules would have to be provided for persons with dual nationalities. If a PTK were a national of two developing countries, either
Considerable advantages flow from adopting this approach. First, it would help the IBDT to conform as closely as possible to existing patterns of taxation. An attempt to single out PTKs for special treatment would be unprecedented and perhaps conflict with international law. But even if this conflict did not exist the singling out of PTKs would provide a focus for public criticism and would make it more difficult to obtain the support of the developed countries and the voluntary compliance of the PTKs. Second, levying the IBDT on all of the developing countries' residents and citizens in the host developed country would allow the IBDT rate to be lowered and still raise the same amount of revenue as would a higher rate applied only to PTKs. Keeping the tax rate low has three major advantages: (1) the emigrant PTK is not likely to engage in tax avoidance or evasion if the amount of tax at stake is not large; (2) the PTK's decision to emigrate is unlikely to be affected by a low rate, thus reducing conflict with fundamental human rights, and (3) inequities arising from the lack of uniform treatment of PTKs, whether due to differences in rate structures, tax bases, and so forth will be less serious.

6. For some developing countries, no difference may exist between levying the IBDT on all of their nationals and residents abroad and levying the IBDT on a smaller subset of only PTKs. This would be true of developing countries whose brain drain consists primarily of doctors, for example, a profession that would clearly be included in all definitions of PTK. However, other developing countries may experience a migration of businessmen, as well as employees of international agencies and multinational corporations. These are the groups that would pose difficult definitional problems. Yet these groups represent a loss of essential operating, leadership and entrepreneurial abilities, not to mention potential suppliers of capital, even if they are not commonly perceived of as part of the brain drain. Given the rationale of the IBDT and the considerations in favour of applying the tax to all developing country residents and nationals, the arguments for applying the tax only to PTKs is not persuasive.

7. Some developing countries, however, might object to taxing all residents and nationals abroad, not because they are worried about reaching businessmen, international civil servants, and so forth, but because they do not want to tax that group of unskilled or semi-skilled individuals euphemistically referred to in Europe as guest-workers. An attempt to exempt this group with a functional definition would raise many of the problems discussed above. A more feasible approach would be to levy the IBDT only on incomes above a certain level. Given normal salary differentials, it should be possible to set the level differently

nationality would be sufficient to subject him to the IBDT. A problem would arise, however, if the IBDT revenues were returned to the countries of origin, since it would then be necessary to decide how to allocate the tax.

It will be more likely that a PTK with dual nationality will be a national of both a developing and a developed country. In this case, rules would have to be provided to determine the extent to which the taxpayer would be subject to the IBDT. The resolution of this problem would have no effect on the taxpayer's status with respect to any other laws.
in each developed country so that the unskilled and semi-skilled workers would be exempt from the tax, irrespective of whether it was their brawn or brain or a combination which produced their income.

B. Selecting a tax base

8. Once the group of taxpayers has been defined, it is necessary to define a tax base; that is, to select or design the rules and principles that will be used in calculating the amount of income subject to the IBDT. Though all countries that employ an income tax must develop this set of rules and principles, no two countries employ identical approaches. This result is not surprising, considering the great variety of items that enter into the calculation of the tax base: capital gains, dividends, interest, royalties, deferred compensation agreements, stock options, annuities, insurance proceeds, gifts, inheritances, alimony, stock redemptions, depreciation, travel and entertainment expenses, charitable contributions, medical expenses, losses, and so forth. Little agreement exists, even in principle, as to the correct treatment of many of these items, and in those cases where agreement may exist, political, social and economic considerations, or administrative constraints lead countries to adopt greater divergent approaches. Accordingly, a large number of alternatives are available for defining the IBDT base and can be broken down into three major choices: using the host developed country's tax base, using the developing country's tax base, or designing a special IBDT base.

Whether the IBDT is applied only to PTKs or to all developing country residents and nationals, some exemption should be provided for individuals temporarily present in the developed country. Applying the IBDT to individuals on a business trip to the developed country, or to employees on short-term assignments is an administrative nuisance not warranted by either the small amount of revenue at stake or the objectives of the tax.

An exemption for short-term visitors to the developed country can be provided by various mechanisms. One approach is to apply the IBDT only to individuals who have entered the developed country under an immigration visa. This approach is administratively attractive, since a list of immigrants should be readily available from the proper authorities. It is possible, however, to spend prolonged periods of time in many developed countries, legally as well as illegally, without obtaining an immigration visa. Certainly the loss to a developing country is the same when a doctor is abroad for five years, regardless of the doctor's status under developed country immigration law. Taxing only those holding immigration visas is therefore likely to be too narrow an approach.

It would be more consistent with the objectives of the IBDT to define the exemption in terms of the length of stay in the developed country. For example, the IBDT might apply if the individual has been present in the developed country for some minimum period of time, perhaps 180 days. By examining the prior flow of individuals between the developing country and each developed country, it might be possible to select a time period that eliminated most of the nuisance cases from taxation. Another approach is to use the developed country's rules of residency. The developed country will normally have to decide at what point the migrant's presence becomes permanent enough to warrant being subjected to the normal developed country tax régime and the IBDT can utilize the same criteria. The IBDT would thus apply whenever the migrant became a tax resident under developed country rules.
1. On using the developed country's tax base

9. Administrative considerations weigh heavily toward using the developed country tax base. Presumably, most PTKs will be paying developed country taxes and will have to determine their developed country base for this purpose. Using the developed country tax base for purposes of the IBDT thus imposes no additional administrative burden on the PTK. More important, the developed country tax administration's normal audit and investigation machinery will be enlisted automatically on behalf of the IBDT, and controversies arising over the tax base will be resolved through the developed country's usual appeal procedures, eliminating the need for any special IBDT machinery.

10. But not all PTKs may have to compute their developed country tax base. For example, employees of international organizations - a large group - are exempt from developed country taxation. To be sure, these persons could be required to compute their developed country tax base for purposes of the IBDT, exactly as if they were taxable under developed country law, but some special arrangement would have to be made for verifying their returns since the developed country tax administration would not be concerned with this tax-exempt group. Alternatively, in the case of the United Nations and other employees under the International Civil Service, the staff assessment may be a satisfactory substitute for the developed country base, even though it would not reach unearned or passive forms of income such as royalties, interest and dividends.

11. Other problems are presented by tax shelters and similar tax avoidance devices that can be used in certain developed countries to reduce substantially a taxpayer's income. Should the developed country tax base be adjusted to eliminate the effects of these tax avoidance devices? Are there circumstances where the PTK should pay a minimum IBDT, regardless of his developed country taxable income? Answers to these questions will vary, depending on the type of provisions found in each developed country's tax law. If the developed country tax administration is computerized, certain adjustments in the tax base should be feasible.

2. On using the developing country's tax base

12. Before adopting a form of the IBDT that is basically an extension of the developing country income tax, the developing country tax base must be examined closely to determine whether it can satisfactorily be applied to PTKs. Since many developing countries will have had little experience taxing individuals abroad, the assertion of citizenship jurisdiction will expose for the first time possible weaknesses in the tax base.

13. A major question is whether the developing country tax base can cope adequately with the relatively sophisticated business practices and conditions in the developed country. Developing country tax law may offer little guidance as to the tax consequences of transactions and practices that are common in the developed country but unfamiliar (or perhaps illegal) in the developing country. Certainly any grey areas or vacuums in the developing country law will be resolved by the PTK in his favour and therefore many transactions may fail to enter into the developing country tax base. The developing country will have to evolve policies for dealing with these transactions, an effort that may or may not be justified depending on the amount of revenue at stake. Alternatively, it may be possible to defer to the developed country's treatment of any item not sufficiently dealt with by the developing country tax base, but this raises the knotty problem of integrating developed country tax law with developing country tax law.
14. Additional difficulties in accommodating the developing country tax base to developed country business practices may arise. For example, some developing countries place a ceiling on advertising, travel, or entertainment expenses. The ceiling is obviously determined in the context of conditions prevailing in the developing country and may be totally unrealistic in the case of a taxpayer working abroad. Even when the ceilings are expressed as a percentage of income, such as a rule limiting deductions for advertising expenses to 10 per cent of sales revenue, the percentage may be grossly out of line with developed country business practices.

15. Other provisions in the developing country tax code may also be expressed in absolute amounts. To take just one example, it is common for countries to adjust an individual's tax burden to reflect the size of his family. A common way of making this adjustment is to allow a deduction in a fixed amount for each member of the family. The amount chosen, however, may not reflect any rational policy if the taxpayer is abroad.

16. The developing country tax base would have to be examined to see whether certain benefits should not be extended to PTKs abroad. For example, many developing countries utilize a system of generous capital allowances or investment credits to encourage domestic capital investment. At the time these benefits were first introduced, investment in capital assets abroad may have been uncommon and thus no thought was given to limiting the benefits to only domestic investment. A country might not wish to extend these benefits to foreign investment, however.

17. On the other hand, a developing country may decide to extend a special deduction to taxpayers abroad to mitigate burdens not imposed on taxpayers within the country, such as larger-than-normal moving expenses, or the costs of sending children to special schools.

18. In order to place the preceding problems in perspective, it is useful to distinguish salaried employees from self-employed individuals. Advertising deductions, travel and entertainment expenses, depreciation and investment allowances have relatively little impact on salaried employees, who may constitute the heart of the brain drain for many developing countries. To be sure, even these employees may pose difficulties if part of their remuneration consists of deferred compensation agreements, profit sharing and pension plans, stock options, or other sophisticated fringe benefits with which the developing countries may have little experience.

3. Adoption of a special tax base

19. The problems that accompany the use of either the developed country or the developing country tax bases can be overcome by adopting a special, independent base for purposes of the IBDT. Indeed, even if no problems existed with respect to using the developing country or the developed country base, a special IBDT base is necessary in order to maintain equality of treatment among PTKs having the same before-tax gross income. Unless the same set of rules were used in calculating their tax bases, PTKs having the same before-tax gross income may not have the same taxable income. For example, if the developed country tax base

2/ In one sense, adjustments to the developed country tax base of the nature discussed in Section B.1 of this appendix would be a first step toward the design of a special IBDT base. But such adjustments would take as their starting point the developed country tax base, and may therefore be inadequate in achieving uniformity of treatment for all PTKs.
is used, the calculation of taxable income will vary depending on the PTK's host country; if the developing tax base is used, taxable income will vary depending on the PTK's country of origin. The latter result may not be objectionable where the IBT is essentially an extension of the developing country income tax, but where the IBT revenue is earmarked for brain drain funds or other general developmental spending, little justification exists for applying different rules in calculating the PTK's tax base.

20. Whatever merits a separate IBT base has, ease of administration is not one of them. All the administrative problems identified in the tax with respect to the use of a surtax would be greatly compounded, since no country or group of persons would have had any experience working with the new tax base. Extensive mass education programmes would thus be necessary to educate taxpayers and their accountants and lawyers. Integrating the IBT with the developed country withholding procedures might be formidable if the two tax bases differ greatly. A new IBT staff would be required to answer taxpayer questions, perform the necessary audit, intelligence, and collection functions; some form of appeal procedure would also have to be established.

21. The administrative problems caused by the use of a special IBT base are substantial, but not insurmountable. The problems are similar to those faced by a country when it introduces an income tax for the first time. Realistically, support for the IBT will be a function of how easily the tax can be implemented without causing major disruption or changes in existing practices. The spectre of a new international bureaucracy, which may be required if a special base is used for the IBT, would dampen the political attractiveness of the tax.

C. Selecting a rate schedule

22. The final step in calculating the IBT involves applying a tax rate to the migrant's tax base. The rate structure of the IBT can be based on the developed country's rate structure, the developing country's rate structure or can be specially designed.

1. Using the developed country rate schedule

23. In its simplest form, the IBT rates could be set at some percentage of the developed country's tax rates. For example, every tax rate in the developed country schedule could be increased by 10 per cent and the increased rates applied to the IBT base.

24. If the developed country's tax base were used as the IBT base, (and the case for using the developed country's rates is strongest when the developed country's base is also used), this procedure is equivalent to a 10 per cent surtax; that is, a 10 per cent tax levied on the developed country tax. The PTK would calculate his tax liability, under the developed country's normal rules, using the developed country's regular tax schedule; the 10 per cent IBT would then be applied to the developed country tax liability.

25. A major advantage of the surtax approach is that it automatically relates the additional tax burden imposed by the IBT to the developed country's tax. Since the developed country's tax reflects what is regarded as a fair tax burden given conditions in the developed country, the surtax is a convenient means of assuring that the additional burden resulting from the IBT will not be unreasonable.

26. The political attractiveness of the IBT may be enhanced by the use of a surtax, since this approach is easily understood by laymen. Those concerned
about the effect of the IBDT on an individual's decision to migrate can easily calculate the additional tax burden at any given income level. A surtax set at 10 per cent, for example, should eliminate fears that the IBDT will curtail migration or result in wholesale renunciations of citizenships or other means of avoiding the tax. Moreover, because the rate would be set by an international agency, a developing country would be powerless to use the rate as a means of either restricting emigration or punishing those who have already migrated.

27. If the surtax were a flat percentage of the developed country tax, such as 10 per cent, the IBDT would mirror whatever progressivity was inherent in the developed country rate structure. If different degrees of progressivity were desired, the rate of the surtax could be made a function of the developed country tax liability. For example, if the IBDT wanted more progressive rates than that evidenced by the country's rates, the rate of the surtax could increase as the amount of the developed country tax increased.

28. Administrative considerations also argue in favour of the surtax approach. Although not simple to administer, a surtax causes fewer problems for the developed country's tax administration than do other approaches.

29. Another advantage is that the surtax can be easily integrated with the assessment on the host developed country, as discussed in Chapter IV above. For example, the assessment on the developed country could be set at a percentage which could be greater than 100 per cent of the surtax. Since the developed country would have information available as to each PTK's surtax, it should be relatively easy to calculate its assessment. If the surtax were the exclusive measure of the assessment, it would eliminate the need for gathering other data.

2. Using the developing country's rate schedule

30. As was illustrated in the text, the developing country's rate schedule might produce unsatisfactory results if applied to a PTK abroad. Developing countries commonly use very progressive rate structures, and a salary that appears extravagant by developing country standards, though only adequate by developed country standards, is likely to be heavily taxed. When compared with living conditions in the developed country, the developing country tax may be high enough to border on the confiscatory. Granting a credit for the developed country tax does not eliminate this problem, since the overall burden on the PTK is still determined by the developing country tax rate.

31. As an illustration, consider a PTK in the United States with $20,000 taxable income and a United States tax liability of $5,000. Assume that the PTK's country of origin uses a steeply progressive rate schedule. If $20,000 is considered by developing country standards to be a substantial salary, the PTK is likely to be taxed at a very high developing country rate. If the developing country tax is say, $15,000, and if a credit is granted for the developed country tax, the overall burden on the PTK is $15,000 ($5,000 paid to the United States and $10,000 paid to the developing country). When measured against other taxpayers in the United States the PTK bears a $10,000 additional tax burden. Expressed in percentages, the overall tax burden on the PTK represents 75 per cent of his salary, compared with a 25 per cent burden on United States taxpayers at the same income level.

32. Even developing country rate schedules that were not progressive might be unsatisfactory when extended to individuals abroad. Suppose in the example above, the developing country taxed all income at a flat, proportional rate of 10 per cent, so that the PTK's developing country tax was $2,000. If the
developing country granted a credit for the United States tax, no developing
country tax would be payable. If no credit were given, the total burden on the
PTK would equal the sum of the developed country and developing country tax, or
$7,000. The overall tax burden on the PTK would still be 40 per cent greater
than the tax burden on a United States taxpayer with a similar income, and this
must be considered harsh. Only if the developing country tax were a small
percentage of the developed country tax, would the total burden on the PTK be
reasonable.

33. An attempt to overcome these problems could be made by developing a special
schedule for use with every host developed country. The schedule would be
designed to generate either (a) a tax that was always slightly higher than the
developed country tax, assuming the developed country tax were creditable; or
(b) if the developed country tax were not creditable, a tax that was a modest
percentage, perhaps 10 per cent, of the developed country tax. A problem arises,
however, if great disparities exist between the developed country and developing
country tax base; the greater the disparities the more difficult it becomes to
design the desired rate schedule. To illustrate, consider a PTK with $20,000
income, as determined under developed country rules, and a resulting $5,000
developed country tax liability. Assuming no credit were to be given for the
developed country tax, a satisfactory developing country rate schedule would
generate a tax of, perhaps, $500. But the PTK's income, as calculated under
developing country rules, might be more or less than $20,000, and this makes
designing the desired rate schedule difficult. A further complication is
introduced, since a second PTK, also having $20,000 under developed country rules,
would not necessarily have the same income as the first PTK, when calculated
under developing country rules. Only if both had identical sources of income,
identical expenses, and so forth would their developing country tax base be the
same.

34. Designing a satisfactory developing country schedule will be easiest when the
developing and developed country bases are similar; but the greater the similarity
the more closely this approach becomes to the surtax.

3. A specially designed IBDT rate schedule

35. Regardless of whether the developed or the developing country rates are used,
the IBDT paid by PTKs at the same income level (putting aside, for the moment,
the question of which rules will govern the calculation of the PTK's income) will
vary. If the developed country rates are used, the IBDT will be the same for all
PTKs at the same income level within the developed country, but will be different
for PTKs at the same income level in other developed countries. If the developing
country tax rates are used, the IBDT will be the same for all PTKs of that
developing country, at the same income level, regardless of which developed country
they were in, but would be different for PTKs at the same income level who come
from other developing countries. These differences might be acceptable if the
IBDT were an extension of the developing country income tax, but if the tax
proceeds were earmarked for IHRFs or other developmental purposes, the amount
paid by PTKs at the same income level should not be a function of their
developing country of origin or of their host developed country. Eliminating
these differences in order to attain more uniform treatment of PTKs can be
accomplished through the use of a special IBDT rate schedule.

36. To illustrate the options available in designing this special rate schedule,
consider two PTKs working in the United States and the United Kingdom respectively.
Assume both PTKs have the same income, but that the United Kingdom tax is.
US$2,000 and the United States tax is US$750.
(a) **Option 1:** The IBDT is set well below either the United States or the United Kingdom tax.

37. The rate schedule could be designed so that for any given income level, the IBDT will be substantially below either the United States or the United Kingdom tax. For the PTKs under consideration, the IBDT tax rate might be designed to produce a US$50 tax. Both PTKs would pay this in addition to their normal United States and United Kingdom taxes. Because the IBDT burden is modest, no adjustment in their developed country taxes is necessary. Both PTKs pay the same absolute amount of IBDT, although expressed as a percentage of their respective developed country taxes, the additional burden on the United Kingdom PTK is higher. Since for him, the IBDT is equivalent to a 2.5 per cent surtax, compared with a 6.67 per cent surtax for the United States.

(b) **Option 2:** The IBDT is set at a level between the United States and the United Kingdom tax.

38. Suppose an IBDT rate were designed to generate a US$1,250 tax. Unlike option 1, where the tax was substantially below either the United States or the United Kingdom tax, and therefore imposed only a modest additional tax burden on the PTKs (6.67 per cent in the case of the United States PTK and 2.5 per cent in the case of the United Kingdom PTK), here the additional burden is significant and cannot be ignored. Some adjustment would be required in order to accommodate the IBDT. The United States and the United Kingdom could, for example, grant a credit for the IBDT. In the case of the United States PTK, the credit for US$1,250 would exceed the United States tax liability of US$750 and no further United States tax would be due. The United Kingdom PTK would pay the United Kingdom US$750, the difference between the United Kingdom tax and the IBDT (US$2,000 - US$1,250).

39. Option 2 satisfies the objective of equalizing the IBDT paid by PTKs at the same income level and has the further advantage of generating more revenue than Option 1. The higher level of revenue is made possible by the credit provided by the developed country. By agreeing to credit the IBDT against their domestic tax, the United Kingdom and the United States forgo the amounts of tax they would otherwise have collected - US$1,250 and US$750 respectively. This amount can properly be viewed as a form of developed country assessment and could be creditable against any other host developed country assessment that might be levied. The revenue potential of Option 2 is not unlimited; as a practical matter, the IBDT rate cannot be set very much higher than the United States rate, regardless of the credit, without the total burden on the PTK becoming excessive.

40. Despite the attractiveness of the increased revenue under Option 2, some unfairness may be perceived because the IBDT will impose an additional burden on only the United States PTK. The United Kingdom PTK pays the same overall tax burden, US$2,000, both before and after implementation of the IBDT. The United States PTK, on the other hand, experiences a US$500 increase in his overall burden after the IBDT is introduced.

41. The preceding examples considered two PTKs at the same income level without specifying which rules were to govern the calculation of their tax base. It would be consistent with the goal of maintaining international norms to levy the IBDT on its own, specially developed tax base, as was discussed in Part B of this appendix. However realistic it may be for the IBDT to develop its own tax base over the long-term, in the short-term it will be necessary to use either the developing country or the developed country base. For the reasons discussed in
Part B, the developed country tax base is the more suitable candidate. Indeed, when the objective is to compare PTKs at the same income level, the developed country base is especially attractive because more similarity is likely to exist among developed country tax bases than is true of developing country bases. In other words, if the incomes of identically situated PTKs were calculated under the rules of various developed countries, more uniformity in the results is to be expected than if the incomes were calculated under various developing country rules. Therefore, it is more meaningful for the IBDT to compare PTKs at the same income level when their incomes are calculated under the various developed country rules, rather than under the various developing country rules.