PATHWAYS TO GLOBAL TAX GOVERNANCE

PERSPECTIVES FROM THE NETHERLANDS AND THE THINK20 NETWORK

7 NOVEMBER 2018

Universiteit Leiden
The Netherlands

T20
ARGENTINA 2018
THINK 20

European Research Council
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GLOBTAXGOV
A NEW MODEL OF GLOBAL GOVERNANCE IN INTERNATIONAL TAX LAW MAKING

PROGRAMME

13.30 – 14.00	Introduction to the GLOBTAXGOV Project
14.00 – 15.25	Session one: tax competition
15.25 – 15.50	Break
15.50 – 16.50	Session two: tax expenditure
16.50 – 17.30	Roundtable

INTRODUCTION TO THE GLOBTAXGOV PROJECT

THEORY, RESEARCH, OBJECTIVES

THE GLOBTAXGOV PROJECT (i)

OBJECTIVES

The main goal of this research project is to **assess the feasibility of the current global tax governance model.**

To address this objective, this research* will investigate the implementation of the **BEPS minimum standards** in twelve of the countries committed to their implementation, grouped into two categories:

a. Developed countries: Australia, Ireland, Mexico, the Netherlands, Spain, and the US.
b. Developing countries: Colombia, India, Nigeria, Senegal, Singapore, and South Africa.

In order to do so, it is necessary to take into account the **differences in tax systems and tax cultures**, and the differing problems of developing and developed countries.

*This research has **three sub-questions**:

1. Why are these countries participating in the BEPS Project?
2. How will the BEPS minimum standards be transplanted into the tax system of these countries?
3. How can the differences in tax systems and tax cultures of these countries influence the content of these minimum standards?

THE GLOBTAXGOV PROJECT (& ii)

RESEARCH

The project will follow **comparative legal research theories** of legal transplants, legal culture and tax culture.

In order to identify the implementation particularities of the minimum standards in all analyzed countries, a series of **interviews, surveys and workshops** will be carried out, targeted to relevant tax actors in each country (companies, business associations, tax advisors and scholars, government officials, etc.).

The following **research stages** will be followed:

1. Desk research (June 2018 to May 2019)
2. Interviews and surveys (May 2019 to October 2020)
3. Workshops (November 2020 to October 2021)

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SESSION ONE: TAX COMPETITION

T20 Tax competition brief - Abstract

The world is facing a new round of international tax competition that may result in a ruinous race to the bottom, undermining the fiscal capacity of states to respond to global challenges and to implement the Agenda 2030. G20 leaders must take action to strengthen multilateral and cooperative approaches to taxation, curtail harmful tax competition and protect their own tax base as well as that of developing countries.

T20 Tax competition brief - recommendations

Reverse the current tendency to engage in harmful tax competition
G20 leaders should deepen cooperation with regard to the exchange of tax- related information and the fight against Base Erosion and Profit Shifting (BEPS)

- G20 leaders should deepen cooperation with regard to the exchange of tax-related information and the fight against Base Erosion and Profit Shifting (BEPS)
- G20 leaders should agree on a minimum corporate tax rate

T20 Tax competition brief - recommendations

Provide a level playing field for taxation and investment

- G20 leaders should improve the transparency of tax instruments for the attraction of investments
- G20 leaders should work towards a common corporate tax base and explore ways to treat multinationals as single entities
- G20 leaders should promote the use of new technologies to fight trade mispricing and misinvoicing

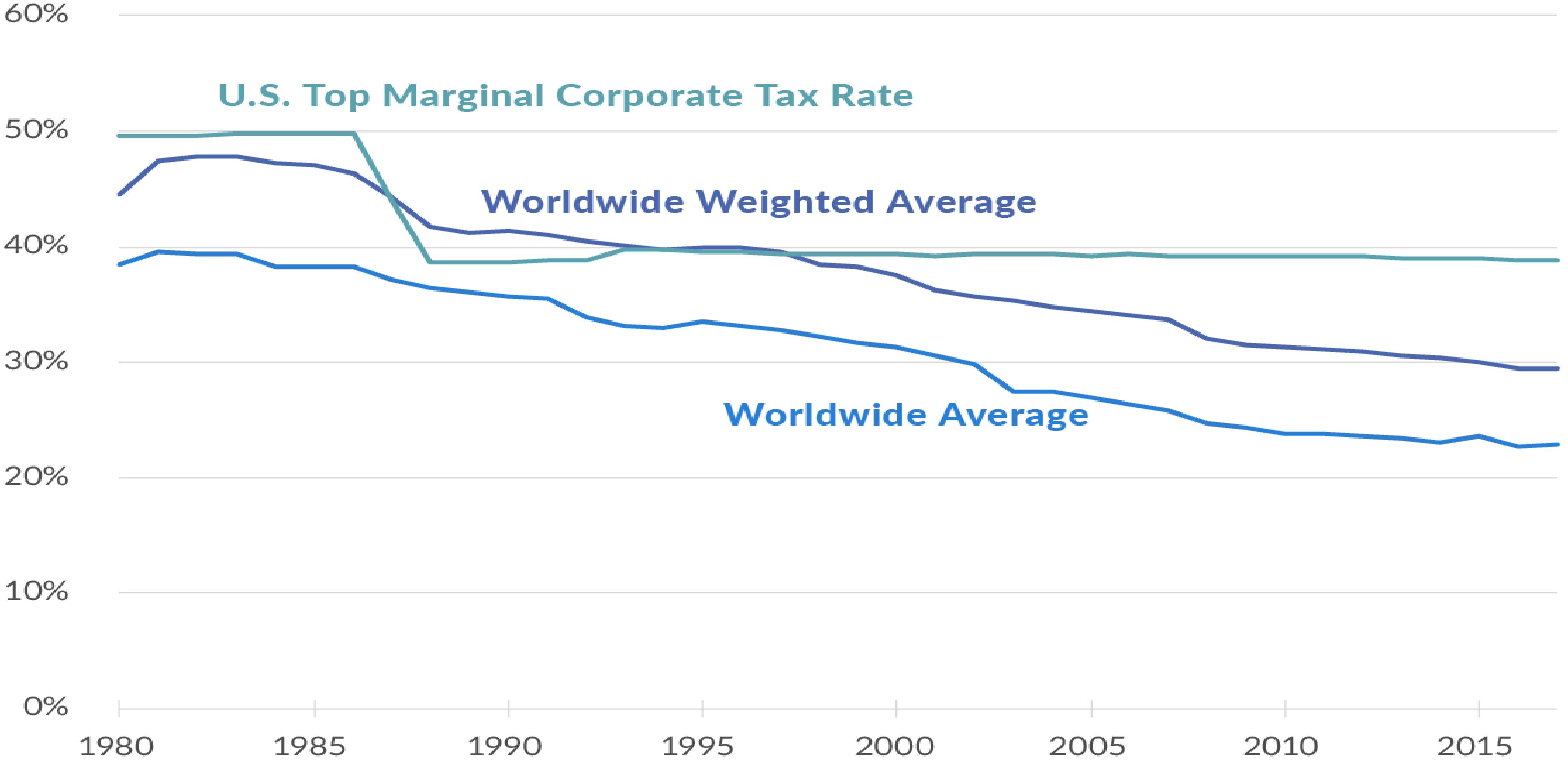
http://www.oecd.org/tax/tax-policy/social-security-contributions-and-consumption-taxes-give-way-to-personal-income-taxes-as-corporate-income-taxes-fail-to-recover.htm

Revenue Statistics 2017 shows that, on average, OECD countries are becoming more reliant on personal income tax (PIT) revenues, with social security contributions (SSCs) and taxes on goods and services declining as a share of total tax revenue. The average share of PIT in total taxation increased from 24.1% in 2014 to 24.4% in 2015, while the respective shares of SSCs and taxes on goods and services (including VAT) fell slightly, according to the report. Corporate income taxes, which fell significantly during the financial crisis, have not recovered, remaining flat at around 8.9% of revenues.

http://www.oecd.org/tax/tax-policy/social-security-contributions-and-consumption-taxes-give-way-to-personal-income-taxes-as-corporate-income-taxes-fail-to-recover.htm

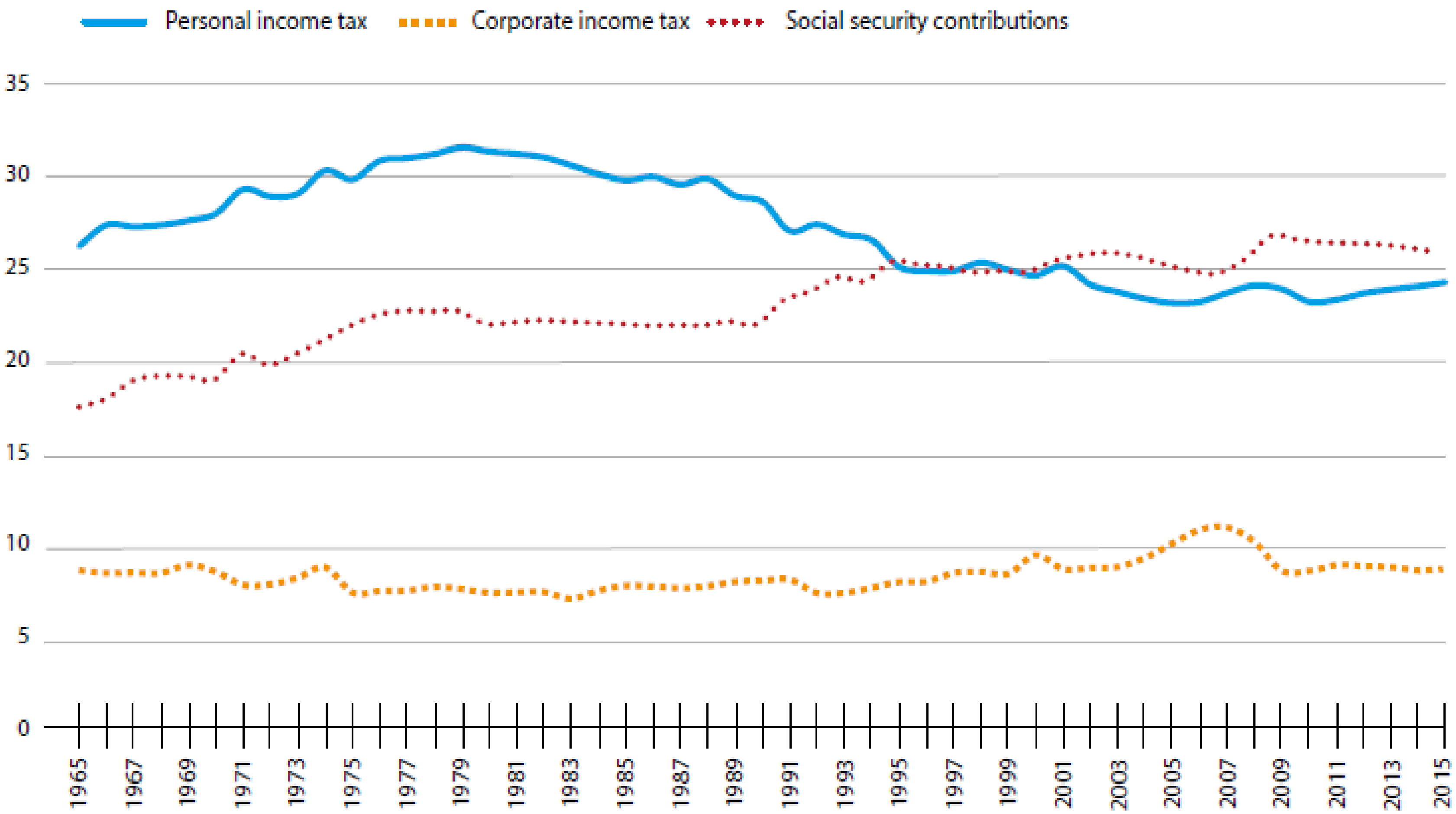
This year's report also confirms three emerging trends in the OECD average tax structure since the global financial crisis: firstly, the share of PIT in total taxes initially fell, from 23.7% in 2007 to a low of 23.2% in 2010, before increasing steadily to 24.4% in 2015; secondly, and by contrast, the share of SSCs and taxes on goods and services initially rose to highs of 26.6% in 2009 and 33.0% in 2010, before decreasing steadily until 2015, to 25.8% and 32.4% respectively; and finally, the share of corporate tax revenues fell during the crisis, from 11.2% in 2007 to a low of 8.8% in 2010, and has since remained relatively stable, at 8.9% in 2015.

Top Marginal Corporate Tax Rates Have Declined Since 1980



Source: Tax Foundation. Data compiled from numerous sources including: PwC, KPMG, Deloitte, and the U.S. Department of Agriculture.

Figure 6. **Trends in tax structures (1965-2015, as % of total tax revenue)**



Tax statement by a major multinational

- The main reconciling items in the 2017 financial statements between the expected rate of 26% and the underlying effective tax rate (26%) include:
- 1. An aggregate increase in the tax rate of 5% due to
- withholding taxes on dividends paid by subsidiary companies, which cannot be offset against any other taxes due (2%)
- business expenses that are not allowed as a deduction for tax purposes (1%)
- withholding taxes on other cross border payments such as royalties and service fees, which cannot be offset against any other taxes due (1%)
- the impact of unrecognised deferred tax assets (1%)
- 2. An aggregate decrease in the tax rate of 5% due to
- benefits from preferential tax regimes that have been legislated by the countries and provinces concerned in order to promote economic development and investment (4%), see further detail below re tax incentives.
- other favourable items including settlements with tax authorities (1%)

Keen/Konrad - The Theory of International Tax Competition and Coordination (2013)

- Perhaps most fundamentally, the literature has not answered the basic question that has loomed over policy debates since OECD (1998): How can one distinguish tax competition that is “harmful” from that which is not? Progress has been made, but not yet enough to confidently determine whether, for instance, the presumption should be against or in favor of preferential regimes.
- While much of the theory in this area predated the greatly increased policy importance of the issues, the risk now is that the world will move more quickly than the theory.

Tax Competition

Good or Bad ?

Advantages

vs

Risks

Tax Competition

Harmful
vs
Non-Harmful ?

- Criteria Preferential Regimes
  - Ringfencing
  - Lack of transparency
  - No EoI
  - Not applying TP
  - No substance requirements

Proposals T20:

- Deepen <u>cooperation</u>
  - EoI
  - BEPS
- Agree on <u>minimum</u> taxation
- Improve <u>transparency</u> on tax instruments
- Work on better system to <u>tax MNE's</u>
  - Work on digital economy
  - Work towards common corporate tax base
  - Explore ways to treat MNE's as single entities
- Promote the use of new technologies to fight trade mispricing and invoicing

What lies ahead?

- FHTP & CoC
  - Preferential → Generic Regimes ?
- TCJA
  - GILTI
  - FDII
  - BEAT
- MNE profits attribution in
  - Digitalizing
  - Globalizing Economy

Tax competition and developing countries

Irma Johanna Mosquera Valderrama

Associate Professor of Tax Law– Principal investigator *EU-ERC GLOBTAXGOV*

Topics

G-20 and T20 process

Tax competition and BEPS

Global Tax Governance and G20

1. G20 and T20 Process

Who provides input to the G20 in taxation?

a) T20

- Each G20 Presidency set up a T20 (think tank network). Also other networks are available C20 and B20. Mostly of G20 countries
- Draft of T20 policy briefs with recommendations to the G20 Presidency

b) OECD reports

Tax policy for inclusive growth; Progress Report Tax Certainty (with IMF); Progress Report Inclusive Framework, General Report; Interim Report (tax challenges arising from digitalization)

http://www.oecd.org/g20/topics/international-taxation/

G20 Presidency decides the topics and also the input to be provided to the G20.

Legitimacy? Transparency? Inclusiveness?

2. Tax competition and BEPS

T20 Policy brief: The different choices made by countries in implementation of BEPS Minimum Standards and the tensions between developed and developing countries

- Some countries also other BEPS Actions e.g. 2 (Hybrid mismatches); 3 (CFC), 4 (interest deductions); 12 (mandatory disclosure). Examples EU ATAD and DAC Directive; Latin America Action 3 and 12.

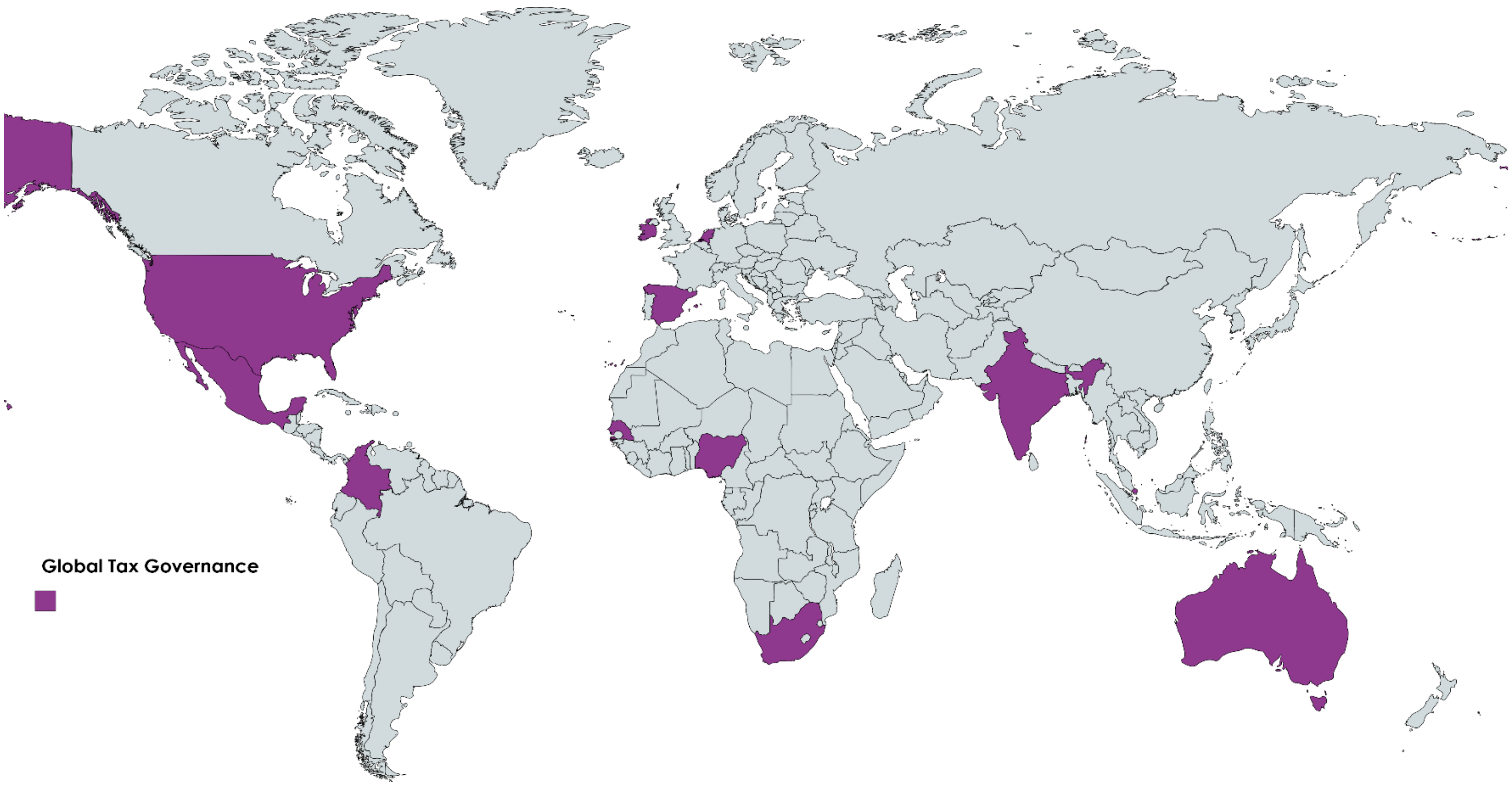
- EU standard of good governance in tax matters
  - As of April 2018 fair tax competition includes the implementation of BEPS 4 Minimum Standards in the agreements concluded by the EU and EU Member States with third (non-EU) countries. Problems (e.g. Philippines in ASEAN agreement)

2. Tax competition and BEPS

In addition to the need for technical assistance and limited resources (personnel and financial support) also other concerns:

- **Caribbean and Latin America**: Expressed their concerns of the consequences derived from not being able to partially or fully implement the BEPS four minimum standards, given their priorities and the features of the tax system of specific countries.
- **Africa**: Highlighted the importance of establishing the benefits and costs that the implementation of the various Actions of the OECD/G20 BEPS initiative would have on their domestic revenue and the need for these countries to maintain some of their preferential tax regimes to attract investment
- **Asia-Pacific region** welcomed a regional approach to encourage further collaboration in the region.
- **Central and Eastern Europe** highlighted the need to address other non-base erosion and profit shifting issues, such as the taxation of the informal (shadow) economy.

Global Tax Governance: GLOBTAXGOV



Global Tax Governance and G20

- The different approaches to the implementation of BEPS Actions lead to peculiar and undesired forms of tax competition. We observe that countries implementing BEPS are sometimes in disadvantage with respect to countries that are not implementing BEPS.

- Balancing competition and BEPS implementation is needed to achieve a global model of tax governance in which developed and developing countries compete on a level playing field.

- We asked the G20 leaders to promote regional cooperation in the implementation of international standards, including BEPS. ***The G20 should facilitate the creation of regional (or, for that matter, sub-regional) peer review and consultancy mechanisms that would allow countries to set and revise their own goals and targets for implementation, getting regular feedback from neighbouring countries.*** The G20 should actively promote regional learning processes.

Visit us at

- **Leiden University, Institute of Tax Law and Economics**

- **GLOBTAXGOV project receives funding from the EU H2020 Research & Innovation Programme and European Research Council**
  Blog https://globtaxgov.weblog.leidenuniv.nl/

- **Twitter: @GLOBAXGOV**

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SESSION TWO: TAX EXPENDITURE

Tax Expenditure and the Treatment of Tax Incentives for Investment

Agustin Redonda

T20 Argentina 2018
Task Force: Trade, Investment and Tax Cooperation

Universitet Leiden
The Hague - November 7, 2018

- Tax expenditures (TEs) are used to pursue different policy goals, e.g. boosting investment and innovation, creating jobs
- Under certain conditions, e.g. when eligibility is linked to tax return data, TEs could be the best option (*Toder, 2000*)
  - Earned Income Tax Credit (*Maag, 2017*)
  - Tax credits for R&D (*Rao, 2016*)

However, no matter their stated objectives, TEs often are:

1. **Opaque**
    - 10/43 G20 and OECD countries do not report on TEs (*Neubig and Redonda, 2017*)
    - It gets worse in emerging and developing countries (*AfDB et al., 2017* and *WB, 2015*).
        - Only 7 African countries report on TEs (*Kassim and Mansour, 2017*)
    - Under-reporting is a key issue!

2. **Costly**
   - 1.5 trillion USD (roughly 36% of direct government spending and 7.5% of GDP) in the US (own calculations, based on *US Treasury, 2018*)
   - LATAM: between 0.7% and 6.6% of GDP (*CIAT, 2017*)
   - Africa: between 3.3% and 7.5% of GDP (*IMF et al., 2015*)

3. **Ineffective** – Worth pursuing goals (or correlation) $\neq$ causality!
    - Patent Boxes (*Alstadsaeter et al., 2015* and *Klemens, 2017*)
    - Special Economic Zones (*Artana, 2015*)
4. **Inefficient** – TEs trigger negative externalities
    - Regressive distributive impact: Mortgage interest deductions (*Hilber and Turner, 2014*), Special tax treatment of pensions (*Duflo et al., 2006*)
    - Environmentally harmful: TEs for fossil fuels (*Sustainable Development Goal (SDG) 12*), Commuting expenses (*Heuermann et al., 2017*)

G20 governments should:

1. Increase **transparency** on TEs by frequently and comprehensively reporting on the fiscal cost of TEs
2. Improve the **design** of tax incentives to minimize windfall profits and negative spillover effects within and across (in particular, poor) countries
3. Phase out TEs that are **environmentally harmful**, e.g. tax incentives for fossil fuels

Improving estimation and reporting of TEs is crucial for several reasons:

- Enhancing transparency and accountability
- Better scrutinizing TEs' effectiveness and efficiency and, hence, better targeting their policy goals
- Easing governments' budget constraints - Domestic Revenue Mobilization (DRM)

We propose a **2-stage strategy** to improve TE reporting:

1. Based on national tax laws and methodologies, governments should report the revenue foregone through TEs - for instance, by sector, tax base, policy objective; as a percentage of GDP as well as percentage of total tax revenue and total spending.
    - Capacity building → checklist style template for TE reporting
    - International comparability → **GTED**, CIAT, OECD on Fossil Fuel Subsidies and R&D)
2. Standardized methodology to estimate the fiscal cost of TEs, no matter how TEs and the benchmarks are defined

Governments should design **tax incentives for investment** to:

1. Effectively impact real activity
   - These provisions are usually poorly designed $\rightarrow$ negligible impact on investment (redundant, windfall gains)
   - Investment treaties should be more flexible regarding ineffective TEs
2. Avoid their use as tax competition instruments seeking to erode other economies' tax bases
   - Harmful tax competition - BEPS
   - Race to the bottom: statutory tax rates v.s. effective tax rates
   - Horizontal inequities

Many TEs have direct or indirect **negative effects on the environment**

- Fossil Fuel Subsidies (FFSs)
  - SDG 12 includes a target calling for a rationalization of "inefficient FFSs that encourage wasteful consumption..."
  - However, according to *OECD (2015)*, FFSs account for roughly 500 billion USD a year (4.9 trillion USD if externalities are considered *IMF, 2015*)
  - $>$ 60% of total FFSs are TEs (*OECD, 2015*)
  - Data is, again, an issue:
    - "a limiting factor in respect of TEs relating to fossil fuels is the extent to which countries release such estimates already" (*OECD, 2015*)
    - **SDG Indicator 12.C.1**: Amount of FFSs per unit of GDP (production and consumption) and as a proportion of total national expenditure on FFs

- Governments should also remove TEs incentivizing an unsustainable use of natural resources, e.g. deforestation
- Internalization of indirect effects (negative externalities) on the environment:
  - Mortgage interest deduction (Prante, 2013)
  - Special tax treatment of commuting expenses (*Heuermann et al., 2017*)

- Online (publicly available and free of charge) database based on **official TE estimates - official TE reports**
  - GTED will be launched together with a companion paper and updated on a yearly basis (Flagship Report)
  - Annual conference as well as Blog and WP Series
  - Initially, only provisions granted by federal (central/national) governments are covered
- Main goals:
  1. Enhance transparency and accountability – improve TE reporting worldwide
  2. Expand research (main source of cross-country data on TEs)
  3. Increase the level of international comparability, e.g. by identifying best-practice in the estimation and reporting of TEs

"*TEs are deviations from the* **benchmark**, *which is defined by national tax laws. Thus, TE estimates are not comparable across countries*"

- Tax deferrals are usually classified as TEs $\neq$ Argentina and Brazil: only those provisions triggering a permanent loss of revenue are TEs
- CO2 tax reliefs for energy intensive firms are classified as TEs $\neq$ if no CO2 tax is in place, no TE is computed
- TE reports are very heterogeneous:
    - Most of reports provide the fiscal cost of TEs, provision by provision $\neq$ Iceland and Portugal: only report aggregated data (by tax base or function)
    - Many countries report estimates for a reduced group of TEs
        - US only report TEs granted through PIT and CIT
        - Under-reporting: UK provide estimates for $<$ 50% of the listed TEs because of "confidentiality, lack of data, disproportionate estimation cost"

- Standardized methodology to estimate TEs, based on national benchmarks
    - Standardized methodology to estimate TEs for the consumption and production of fossil fuels - SDG Indicator 12.c.1: "*Amount of fossil-fuel subsidies per unit of GDP (production and consumption) and as proportion of total national expenditure on fossil fuels*"
- Template to Report on TEs - minimum standards for countries that currently do not report on TEs
- TE Transparency Index

Thank you for your attention

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Ministry of Finance

Setting sun for TE’s?

Rocus van Opstal

Tax Expenditures
T20 7 November 2018

Better monitoring...

- Important!
- NL: since 1998/99 yearly monitoring of Tax Expenditures in the Budget Memorandum
- Past two years: more broad approach to monitoring. Expanded overview based on magnitude and policy relevance
- Now: approximately 100 TE's
- Visibility!

...but also evaluating!

- What is the objective?
- Is it reached because of the TE?
- At what cost?
- Are there more efficient alternatives?

- Sometimes improvements in design are a good solution

- Not always ineffective!

Good TE's

- Example: MIA (deduction for environmentally friendly investments)
- ± € 10 investments / € 1 budget
- 13-40% of users is freerider – relatively low
- 95% SME
- Solid budget rules (& sunset clause)
- However: why tax subsidy, instead of spending subsidy?

Affect policy making

- Difficult

- TE <-> spending subsidies:
  - Subsidies: expenditure ceiling for each department
  - Tax: automatic stabilization

- Once introduced, it’s very hard to abolish a TE

Solutions

- Assessment Framework on new Tax Expenditures
  - part of official "Rules on the budget"
  - 6 questions; 6 x YES is required
  - in practice: not always used

- Very useful: Sunset clause!
  - TE ends at date X, unless...
  - Default set the other way around, determines political dynamics

Global challenge on tax expenditures?

Koen Caminada

Universiteit Leiden
The Netherlands

Seminar Pathways to global tax governance
The Hague
7th November 2018

Introduction

Koen Caminada, professor Empirical analysis of social and tax policy
Leiden University

Academic Director Institute of Tax Law and Economics
Leiden University

Topics

- ❑ Distribution tax-benefits social security and pensions
- ❑ Tax policy
- ❑ Reform social and tax regulations
- ❑ Poverty EU / OECD / LIS

Diagnoses & Policy recommendations

Governments use TE to boost investment, innovation and employment.

However, opaque, costly, often ineffective & unwanted side effects.

Three concrete policy proposals G20 governments:

1. Governments should increase transparency on TE → frequent and comprehensive TE reports.
2. Improvement design of tax incentives. Aim: minimizing windfall profits and negative spillover effects within and across (i.e. poorer) countries.
3. Phase out TE that are environmentally harmful (fossil fuels).

Unconstrained international tax competition

- Lack of evidence supporting theory that tax competition makes governments more efficient.
- Welfare losses arise from externalities generated by one countries' tax rate setting on the welfare of other countries.
- Lower tax rates in other countries moves capital out and reduces tax revenue and public spending, while the best response would be setting the tax rate depending on the marginal value of public spending.
- Game theory (Nash equilibrium is Pareto inefficient): all countries would benefit from an uniform increase in tax rates.
- So, many arguments against unconstrained international tax competition. However, how to get there?

Setting the scene for good public policy: local or global tax governance?

Good public (tax) policy may imply the use of TE.

TE aim at achieving targeted public policy objectives.

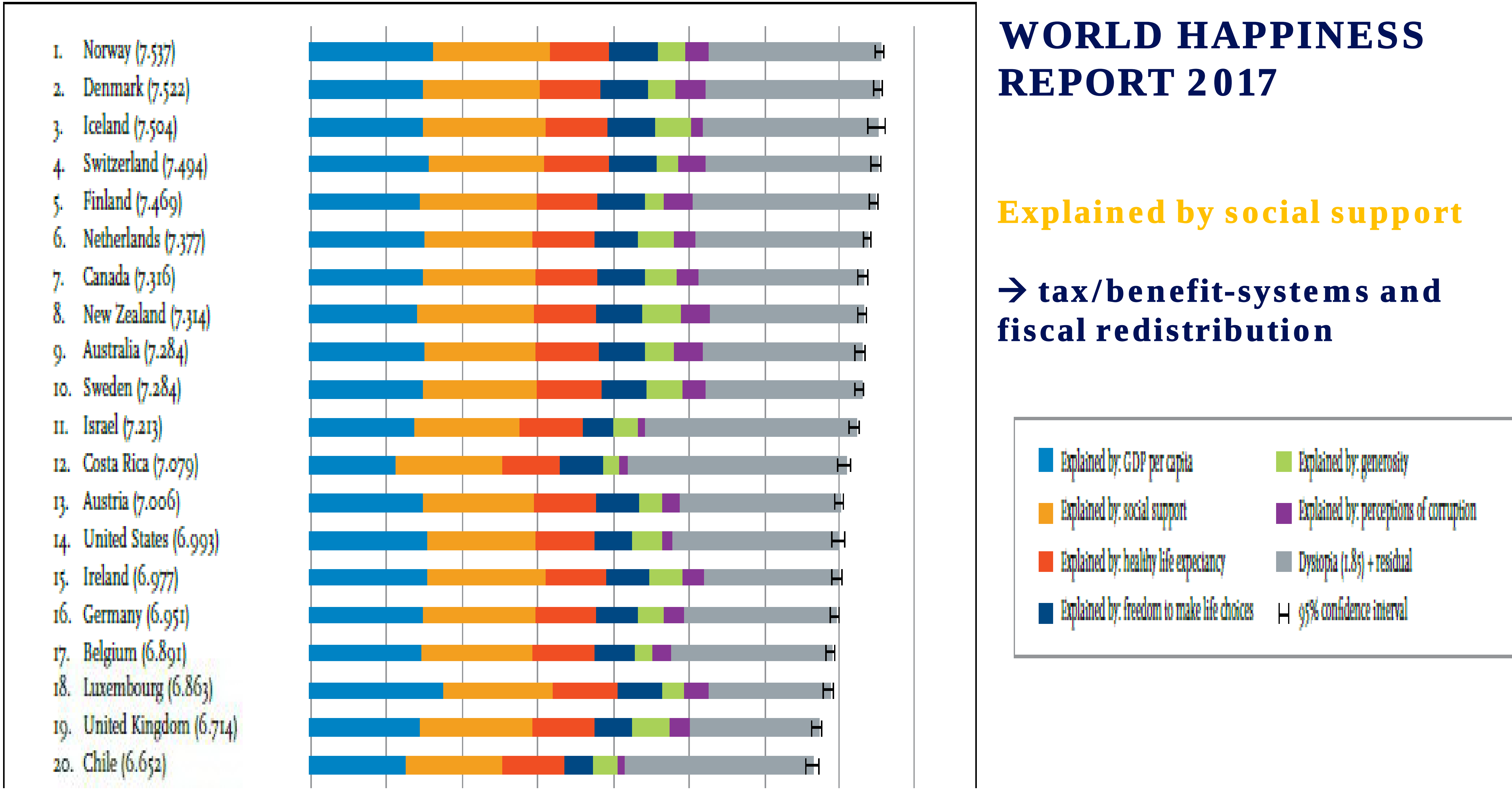
To reduce negative effects of TE (opaque, costly, often ineffective & unwanted side effects) governments do have incentives to redesign the tax code → transparency on TE could be helpful.

Theory of Public Finance – Fiscal Federalism – Power to Tax

Question: why would international coordination (global view) be helpful?

Open to debate (Kyoto Protocol, BEPS).

WORLD HAPPINESS REPORT 2017

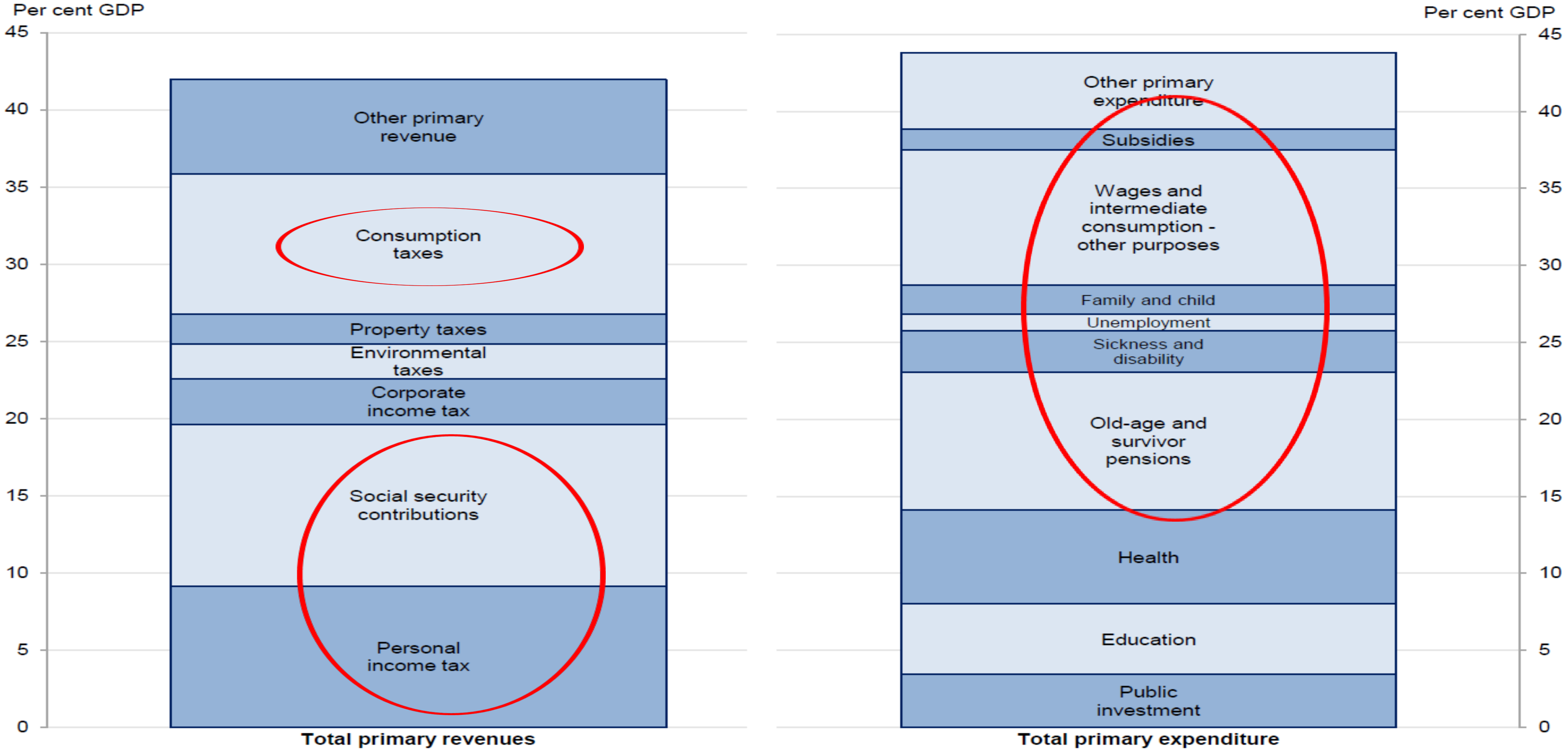


Explained by social support

→ tax/benefit-systems and fiscal redistribution

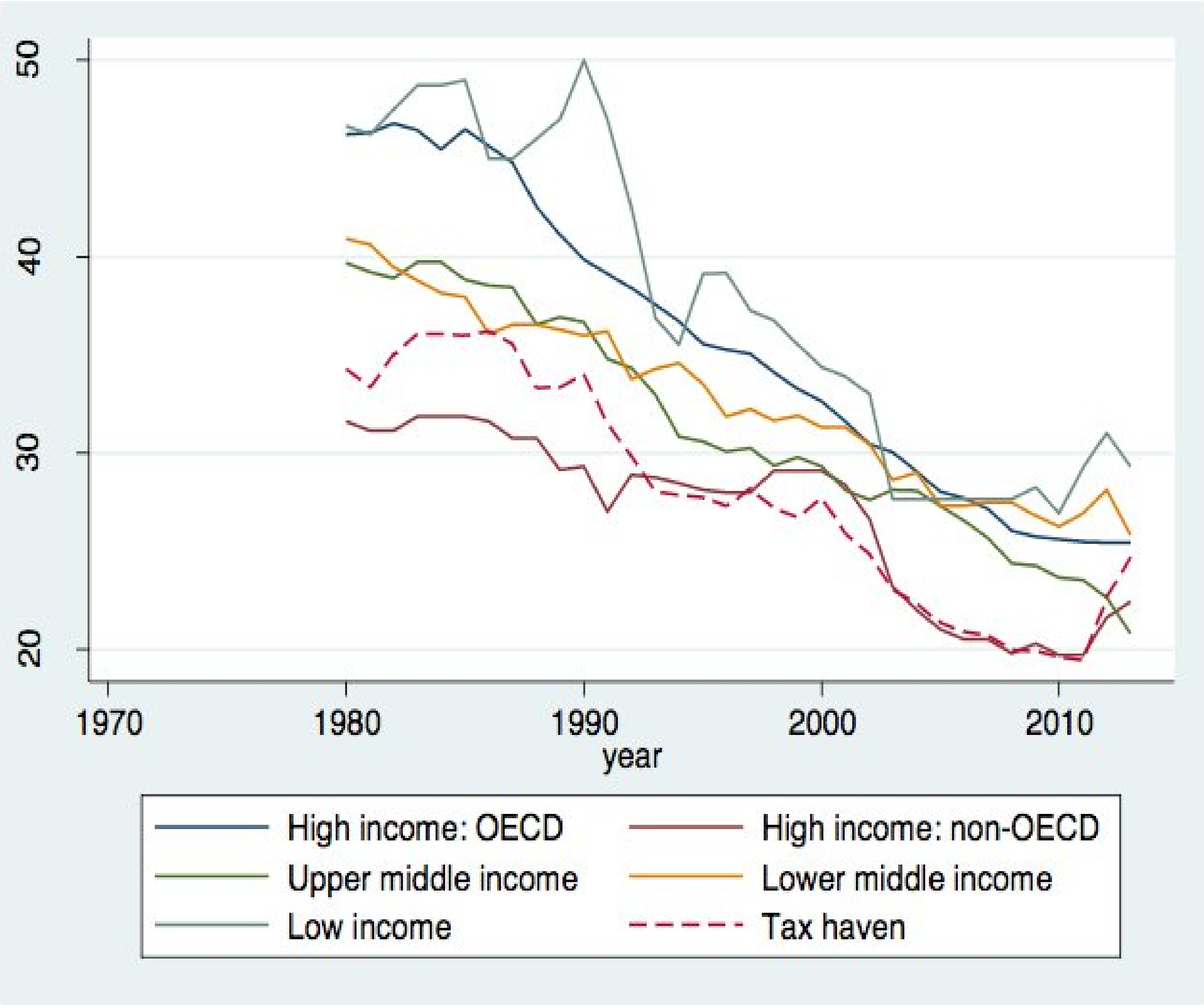

WE CAN
END POVERTY
2015
MILLENNIUM
DEVELOPMENT
GOALS
1
ERADICATE EXTREME POVERTY AND HUNGER
2
ACHIEVE UNIVERSAL PRIMARY EDUCATION
3
PROMOTE GENDER EQUALITY AND EMPOWER WOMEN
4
REDUCE CHILD MORTALITY
5
IMPROVE MATERNAL HEALTH
6
COMBAT HIV/AIDS, MALARIA AND OTHER DISEASES
7
ENSURE ENVIRONMENTAL SUSTAINABILITY
8
GLOBAL PARTNERSHIP FOR DEVELOPMENT

Snapshot of OECD-wide spending and revenue composition = T/B-systems

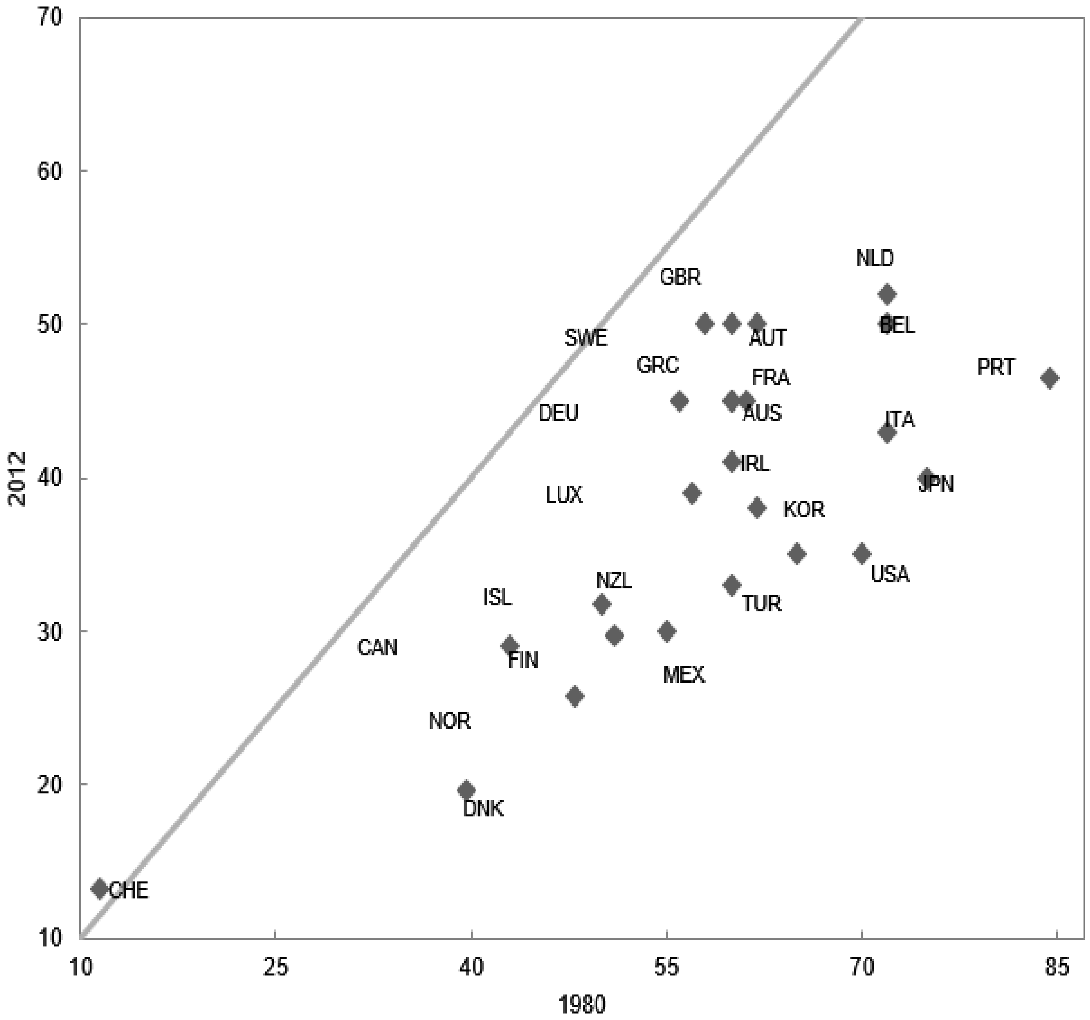


Tax race to the bottom: CIT over time across the globe

Figure 2: Corporate income tax rates, 1980–2013



Revenue from CIT as % Total Revenue



Source: IMF (2014)

Measuring issues TE – getting into empirics

Reporting on TE began in Germany and USA in the late 1960s.

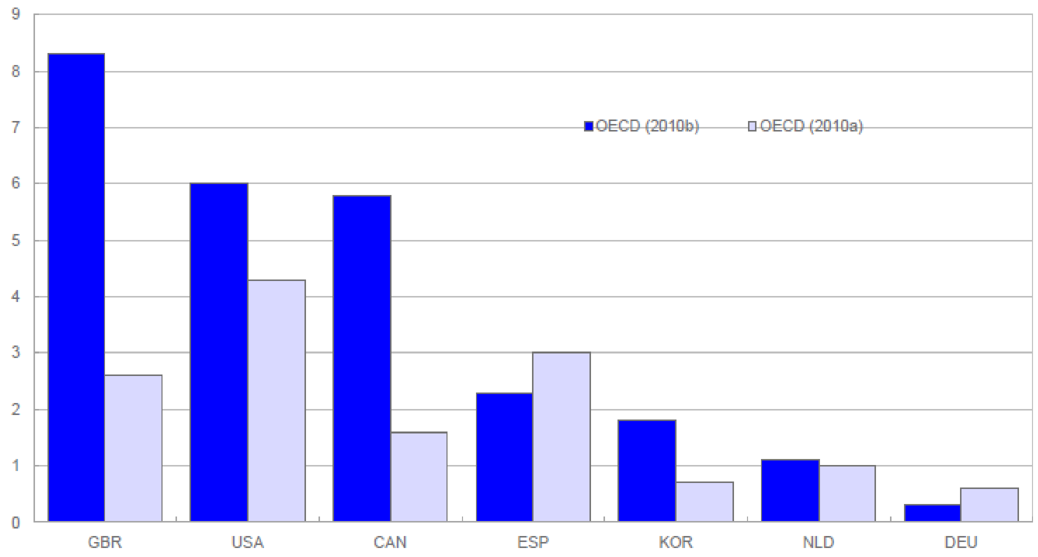
Still difficulties in applying the concept of TE:

1. Absence of general agreement on what should be the reference tax base.
2. Absence of methodology for the calculations; these ultimately make it impossible to compare TE between or among countries.
3. Comparing TE across countries: differences may reflect heterogeneity in the structure of economies, as well as differences in tax rules.
4. Countries may use both tax and non-tax policies to pursue the same objective, and differ in their choice of the mix between tax and non-tax measures.

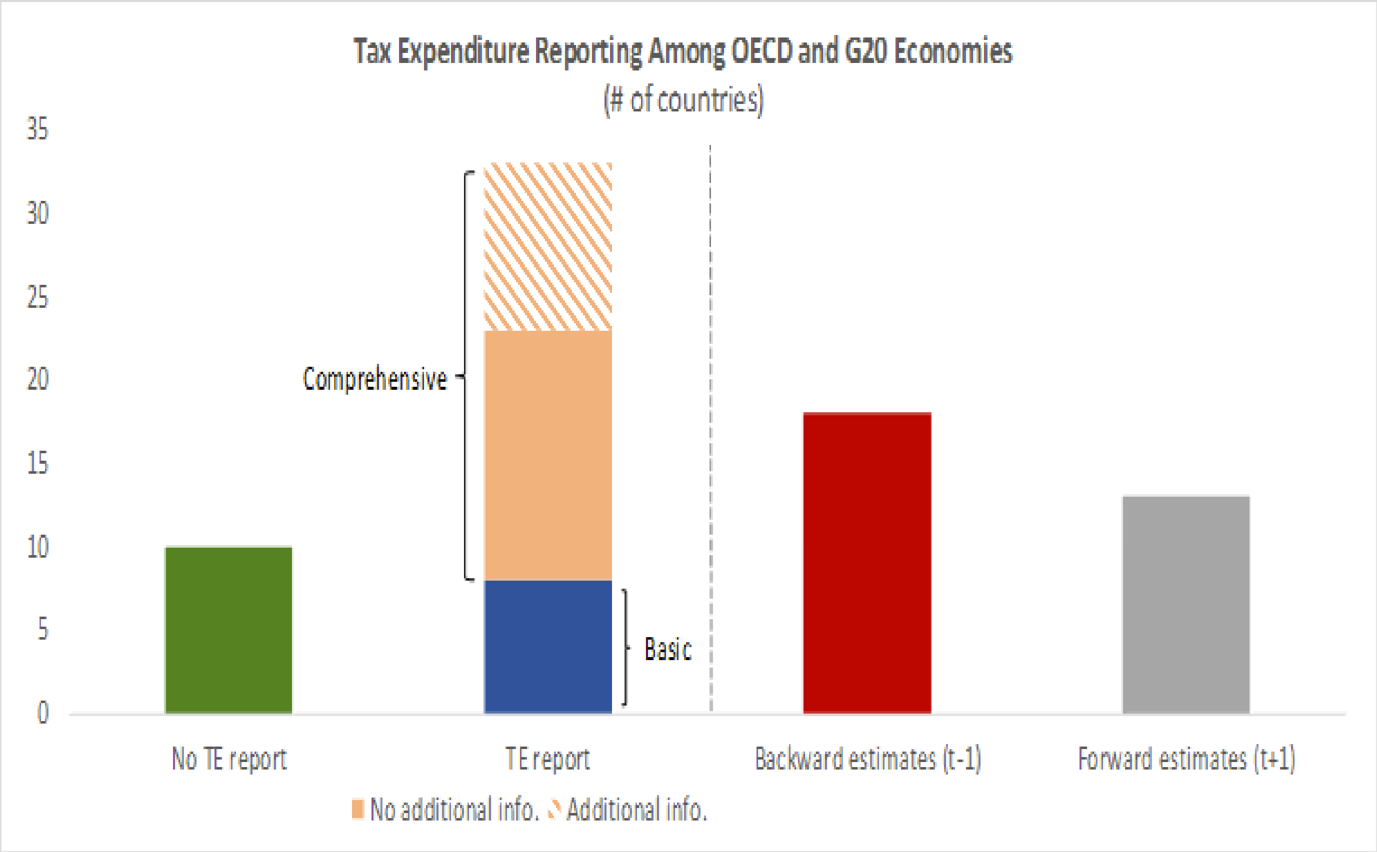
International comparison TE

Comparability is limited: different approaches when preparing TE reports

TEs, PIT + CIT, as % of GDP

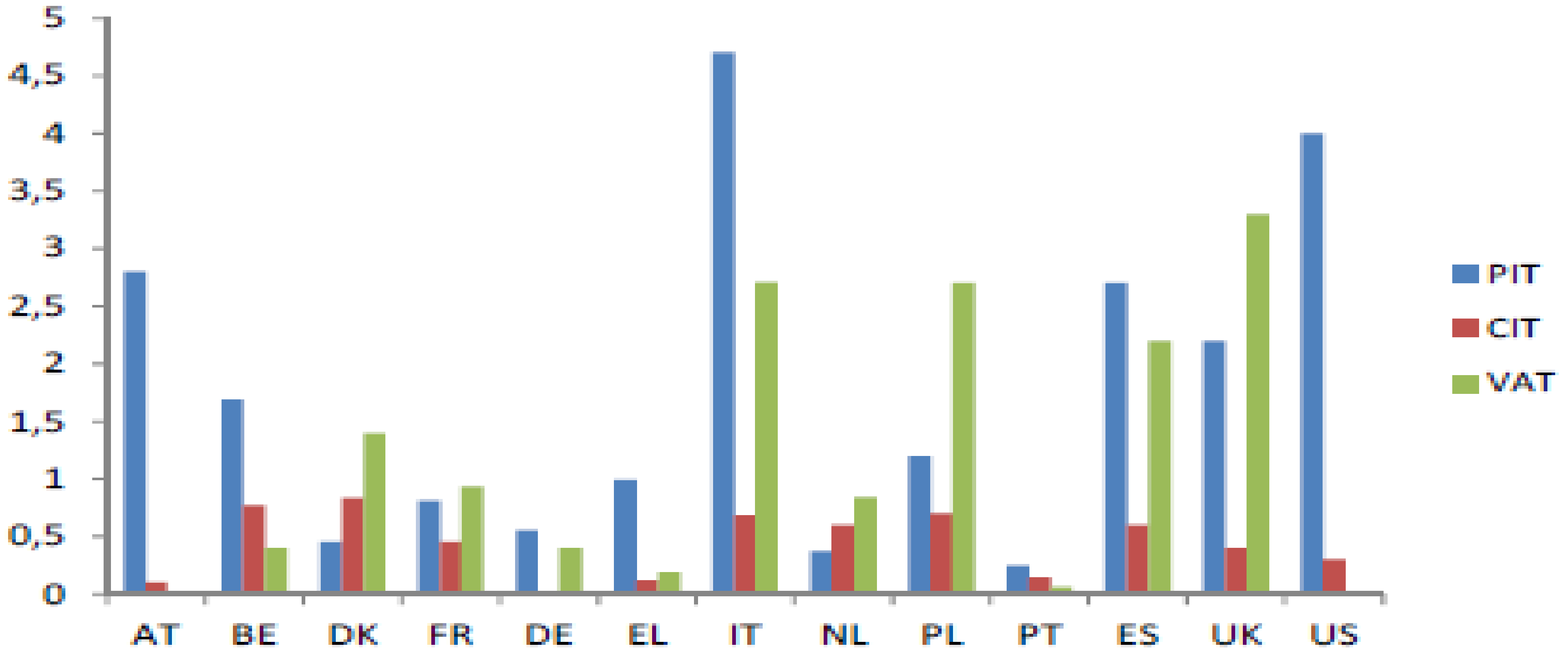


Different years between 2004 and 2008
OECD (2010a) Broad Base – Low Rate
OECD (2010b) – Tax Expenditures in OECD countries
Source: Cournède et al. "How to Achieve Growth- and Equity-Friendly Consolidation", OECD Economics Department Working Paper No. 1088



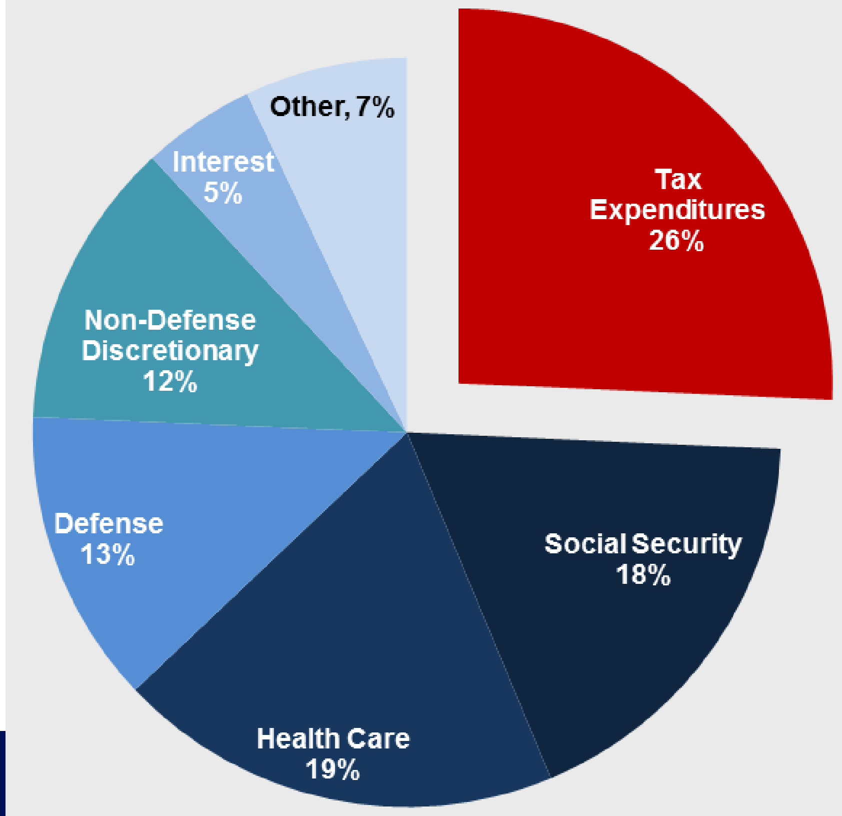
Tax expenditures as % of GDP - breakdown

Size reported TE: PIT > VAT > CIT (source: OECD, 2010)



Still reporting on TE meaningful

1. Lack of democratic accountability → may help explain why costly and inefficient tax breaks have not been reduced = good public (tax) policy
2. Budget process biased in favor of TE:
   - Tax cuts = good; spending = bad
   - Voters don’t perceive full cost: TE framed as tax cuts rather than spending increases.
3. Fiscal illusion: government bigger than it would be with fully informed voters.



Conclusion

1. Focus on separate TE's instead of total TE's → PIT > VAT > CIT.
2. Increase democratic accountability → reduce budget process bias in favor of TE → good public (tax) policy.
3. Efforts to agree-upon in an international setting:
   - Reference tax base and / or methodology for calculations TE?
   - Alternatively: count TE as spending, rather than negative taxes, could improve public (tax) policy?

Local or global view? Maybe some kind of open method of coordination (best-practices), although governments do have incentives to apply proper tax codes by themselves.

ROUNDTABLE

THE ROLE OF THE NETHERLANDS
AND THE G20 TAX AGENDA

THANK YOU.

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A NEW MODEL OF GLOBAL GOVERNANCE IN INTERNATIONAL TAX LAW MAKING