Statement Assoc. Prof. Irma Johanna Mosquera Valderrama ERC GLOBTAXGOV Project at Leiden University

EU FISC Public Hearing 1st December 2020

Do harmful tax practices within and outside the EU create distortions of competition in the Single Market?"

Dear Members EU Parliament FISC Subcommittee on Tax Matters

At Leiden University, we are currently hosting the project GLOBTAXGOV that has received funding by the Starting Grant European Research Council (2018-2023 Grant agreement 758671). This is the first project in the field of taxation that has received this award. The GLOBTAXGOV project investigates the setting of international tax standards by the OECD, G20 and the EU and their implementation in 12 (developed, emerging and developing) countries. I am the lead researcher of this project.

Please find below my comments to the work carried out by the EU on the topic of Harmful Tax Competition vis-à-vis third countries (non-EU countries) including developing countries and small jurisdictions.

One of the research objectives of the GLOBTAXGOV project is to analyze the role of the EU in international tax law making. This question has been addressed in several articles including one regarding the current challenges for the EU regarding Direct Taxation (20 Challenges for the EU in 2020 Special Issue German Law Journal 2020)

This month, at the EU seminar organized by the International Fiscal Association, Benjamin Angel from the EU Commission mentioned the need for better communication from the Commission towards the EU Parliament, and better coordination between EU countries and the EU Commission mainly regarding the criteria for the listing of non-cooperative tax jurisdictions by the Code of Conduct Group.

In my view, this need for communication and coordination should not be only vis-à-vis EU countries and EU Institutions, but also vis-à-vis third (non-EU) countries including developing countries and small jurisdictions. Even though, it has been established that harmful tax practices exist and that something should be done about it. The process carried out by the Code of Conduct Group and the EU Commission should be transparent and clear on the consequences for developing countries including small jurisdictions.

Therefore, the focus should not be only on the criteria for listing, but also on (i) the consequences of the application of the Standard of Tax Good Governance, (ii) the transparency, legitimacy and accountability of the work carried out by the Code of Conduct Group and (iii) the use of the list of non-cooperative jurisdictions for developing countries and small jurisdictions.

My statement will further elaborate in this Standard, the work carried out by the Code of Conduct group and the consequences for developing countries including small jurisdictions.

Standard of Tax Good Governance

The work on the standard of good governance in tax matters has been discussed since 2008, when the ECOFIN Council introduced the standard with a view to tackle tax fraud and tax evasion. At that time, the standard included transparency, exchange of information (on request) and fair tax competition. Later on, several international tax developments have changed the content of this standard. As of April 2018, this standard includes transparency, exchange of information (on request), fair taxation and the BEPS 4 Minimum Standards. This has been also reinforced in 2020 by the EU Commission in the New EU Tax Package (July) and by conclusions from the ECOFIN Council (November).

The EU Standard of Tax Good Governance Standard has been introduced as a pre-condition for third (non-EU) countries that receive EU development aid, conclude strategic partnership agreements, free trade and economic partnership agreements and more recently as a standard that determines whether the third (non-EU) country should be included in a single EU common list of non-cooperative jurisdictions.

In the past, I have addressed the EU Standard of Tax Good Governance and I argued that this EU standard has not only changed throughout the years, but it has also raised concerns of legitimacy of the EU standard in respect of third (non-EU) countries including developing countries. See the EU Standard of Good Governance in Tax Matters for Third (Non-EU) Countries (Intertax 2019)

For instance, even though countries are assessed on the Standard of Tax Good Governance, one term that requires further clarification is the use of **fair tax competition and fair taxation**. The use of the term fairness has also been addressed by the EU Commission in the EU new Tax Package (July 2020). In this Package, the EU Commission introduced an Action Plan for Fair and Simple Taxation supporting the recovery strategy in light of the COVID-19 crisis. In this Communication, the reference is to fair, efficient and sustainable taxation, and to the need to pay fair share and to tackle tax evasion and tax avoidance.

The concept of tax fairness generally, and fair tax competition in particular, has been used in tax policy over the last decade, and its importance is set to increase further in the wake of the COVID-19 crisis. Yet, the concept it is still an unclear concept, and susceptible of attracting different interpretations. For instance, in research carried out with I. Burgers (2018), we demonstrated that fairness is a vague concept that can be approached from different perspectives, and these differences are shown in the way that civil society, business, international and regional organizations refer to fairness.

In respect of **BEPS**, some of these concerns are that the standard is going beyond of the BEPS Project, by asking countries to not only participate in the BEPS Inclusive framework but also to receive a positive review on the BEPS 4 Minimum Standards. Even though the EU Commission has mentioned that developing countries will receive help to meet this Standard, it is not for the EU to decide on whether or not countries should participate in the BEPS Inclusive Framework and to make aid conditional to a positive review.

This affects the tax sovereignty of countries including developing countries that are required to accept this standard so that EU funds are granted, and trade and cooperation agreements are being concluded. Scholars have argued the lack of legitimacy of the BEPS Project, and at this stage, it is not yet clear to what extend the BEPS 4 Minimum Standards benefit developing countries. Therefore, the condition to not only commit to BEPS but also to receive a positive review, puts pressure in developing countries to commit to BEPS. In a blogpost in GLOBTAXGOV we argued that developing countries face problems regarding lack of resources (personnel, financial) to implement the BEPS Minimum Standards, and to participate in the peer review meetings at the OECD Secretariat in Paris.

Finally, the standard is not applicable by the EU in the same way for all countries, in some cases only exchange of information (China), exchange of information, transparency and elimination of harmful tax practices (Canada and Japan), transparency, exchange of information and fair tax competition (South Korea) and standard of good tax governance in general (Philippines).

Therefore, the application of this Standard by the EU in respect of third (non-EU) countries including developing countries should be clear transparent and should take into account the needs of developing countries including clarifying, what does it mean fair taxation? fair tax competition? In addition, more coordination is needed between EU Institutions (EU Commission, EU Parliament) and EU countries on how this standard is being used by the Code of Conduct for the list of non-cooperative jurisdictions. The Code of Conduct will be addressed below.

The Code of Conduct and developing countries

In general, the Code of Conduct work has an indirect relevance for other third countries, among them developing countries which do not have any harmful tax regimes and which might rather lose tax revenue because of the harmful tax practices by other countries. Research that my colleague PhD fellow Frederik Heitmüller in the GLOBTAXGOV project carried out has shown that other countries sometimes lack the capacity to enforce anti-avoidance measures. When the Code of Conduct contributes to eliminating harmful tax regimes in other third countries, this may indirectly shield developing countries from tax avoidance.

However, the impact of the Code of Conduct and the use of the list of non-cooperative jurisdictions on “small jurisdictions” especially the overseas countries and territories of EU countries should be taken into account by the EU. These “small jurisdictions” – small islands in particular – have little economic weight in the global tax landscape. These small jurisdictions face unique economic challenges due to their small population, limited resources and excessive dependence on international trade.

Research carried out by Germaine Rekwest on these small jurisdictions shows that these jurisdictions have focused on attracting foreign investment by offering tax incentives mainly due to their limited resources, the risk of natural disasters, and more recently, their need for economic recovery due to the COVID-19 crisis. The role of tax incentives will be discussed below.

The Code of Conduct and the role of tax incentives

In the EU new Tax Package (July 2020), the EU Commission stated that the work carried out by the Code of Conduct Group requires a new model of governance that provides for more transparency and effectiveness. But in my view, the revision of this work should take into account the concerns of developing countries regarding the legitimacy of the work carried out by the Code of Conduct and how this affect the need of countries to attract investment by means of tax incentives.

Whereas tax policy in general and issues related to harmful tax practices in particular are, up to a large extent, the responsibility of national governments, EU institutions do play a crucial role when it comes to coordination and collaboration among Member States. For instance, the Code of Conduct for business taxation requires EU Member States "to refrain from introducing any new harmful tax measures ("standstill") and amend any laws or practices that are deemed to be harmful in respect of the principles of the Code ("rollback"). Since (i) tax benefits for non-residents, (ii) tax incentives for activities with negligible impact on national tax bases, and (iii) tax advantages in the absence of any real activity are at the heart of the definition of the harmful tax competition concept, the role of EU institutions is crucial to align tax policy within EU countries with International tax standards.

As in the case of Carbon Border Adjustment, aggressive tax strategies by EU Member States (particularly, the implementation of tax provisions that act as trade barriers) can be significantly harmful for developing countries since these provisions might hinder the competitiveness of products imported from these jurisdictions for the EU market. The potential impact on exports to the EU, could trigger significant negative effects on domestic revenue mobilization and the real economy in those countries (Response Oxfam Public Consultation EU Carbon Border Adjustment Mechanism).

In terms of transparency, tax expenditure reporting should be strengthen at EU level, for instance some Member states (e.g. Hungary, Romania) providing very poor data (quantity and quality) on tax expenditures and 3 Member States (Cyprus, Luxembourg and Malta) not even reporting at all), which makes accountability in this area particularly problematic. On tax expenditure, see for instance recent policy brief by Agustin Redonda and Rita de la Feria: Tackling Inequality Through Tax Expenditure Reform Task Force “Social Cohesion and the State” published on the T20 Saudi Arabia website.

Against this context, tax incentives are particularly worrisome since these provisions are often used as tax competition instruments with the sole purpose of eroding other countries tax bases. Even though developing countries need tax incentives, in the GLOBTAXGOV Project, we have argued the need for a evaluative framework of tax incentives in developing countries (see blogpost). This framework takes into account not only the administrative considerations and legal drafting of tax incentives, but also the link of tax incentives to the sustainable development goals (SDGs). The main elements of this framework are

- Systematic review of tax incentives;
- Clear target and eligibility criteria for granting the incentive;
- Tax incentives should be transparent, and the granting of the tax incentive should not be discretionary;
- Tax incentives should have a fiscal budget and ceiling;
- One institution to monitor and administer the incentives. The use of one stop shop agencies should be encouraged;
- Prevent the use of excessive use of laws/regulations to regulate tax incentives

In several workshops that GLOBTAXGOV has co-organized with Agustin Redonda (Council on Economic Policies) we have highlighted the importance of transparency, and accountability of these incentives in developing countries also in times of COVID19 (see report seminar 24 June) .

Therefore, achieving fair taxation for developing countries and small jurisdictions will require a more inclusive approach by the EU, focused on fostering reciprocity, better communication and coordination for involved parties. This inclusive approach will benefit both EU and non-EU countries, including developing countries and small jurisdictions. A more inclusive approach to coordinating EU partnerships and trade agreements, which acknowledges the need for both parties to collaborate in their mutual interest, will enhance the EU work towards a more level playing field of taxation.

Hopefully these comments will be useful to the work currently carried out by the FISC Subcommittee on Tax Matters.

With kind regards,

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View our ERC funded project Global Tax Governance in International Tax Law Making (GLOBTAXGOV) https://globtaxgov.weblog.leidenuniv.nl/