

**Tax Transparency and Tax Co-ordination:
a New Era for Tax Reforms
in a Globalised World**

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*Political Economy of Tax Reforms Workshop
October 19, 2015*

**Tax Transparency and Tax Co-ordination:
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Key themes on political economy of reform of international corporate taxation

- International corporate tax system is in need of fundamental reform
- Many initiatives taking place in the European Commission and OECD
- Only reform targeted at fundamental problems is the CCCTB
 - But unlikely to be implemented as it generates gainers and losers
- A stable system needs to be incentive compatible – ie. countries would not have incentive to undermine it

Outline

1. Problems of the international corporate tax system
2. Main reforms and reform proposals
3. Transparency
4. Co-ordination and competition
5. Incentive compatibility

1. Problems of the international corporate tax system

- **Active** business profits are taxed in the **source** country (OECD Model Tax Convention Article 7)
- **Passive** income is taxed in the **residence** country (OECD Model Tax Convention Articles 10(dividends), 11 (interest) and 12(royalties))

And taxation of transfers governed by **arm's length principle**

Source v Residence

Concepts date back to 1920s

- But applied now to affiliates of multinational companies
- Is residence of an affiliate a good place in principle to tax eg. royalty income?
 - OECD / Commission think not if there is no economic substance there
 - So revisit the basic principles

Active v Passive income

Is this distinction any longer a reasonable compromise?

- Not if forms of income are easily manipulated
- For example, treating debt and equity differently invites planning
 - Is there any good reason to treat them differently?
 - Is restricting interest relief to a proportion of earnings (as proposed by OECD) an appropriate response?

Treating affiliated entities as independent

Is the principle of treating affiliates of a multinational as independent any longer appropriate?

- Principle seems an end in itself. 2 examples:
 - Can we allocate risk between affiliates?
 - Can a tax haven affiliate really finance activity elsewhere under a cost-sharing arrangement?

If the haven affiliate were independent, yes. But if not, then no.

2. Main reforms and reform proposals

1. European Commission

June 2015:

A Fair and Efficient Corporate Tax System in the EU: 5 Key Area for action

2. OECD

October 2015:

BEPS project - reports on 15 Action Plans published

A Fair and Efficient Corporate Tax System in the EU

1. CCCTB

2. Ensuring effective taxation where profits are generated

3. Additional measures for better tax environment for business

4. Further progress of tax transparency

5. EU tools for coordination

CCCTB

Within EU, replace existing system completely

- Single tax base for any company
- Single calculation of EU-wide profit
- Allocated to countries by a formula, based on location of capital, employment and sales
- Each country taxes its share at its own rate

A Fair and Efficient Corporate Tax System in the EU

1. CCCTB

2. Ensuring effective taxation where profits are generated

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OECD BEPS Project

- 2 year programme, completed this month
- 15 Action Points, covering many aspects of international tax planning

Essentially aiming to close “loopholes” in the existing,

- Possible new principle introduced: tax in the place of economic substance
 - What is economic substance?
 - If a new principle, how does it relate to existing principles?
 - If not, and it is applied only in some circumstances, will that create further distortions and/or opportunities for planning?

3. Transparency

European Commission Tax Transparency Package, March 2015

- Tax rulings
- New transparency requirements for multinationals
- Reviewing Code of Conduct on business taxation
- Quantifying scale of tax evasion and avoidance
- Repealing the savings directive

Transparency on Tax Rulings

October 6: Unanimous agreement by member states on automatic exchange of information on cross-border tax rulings

- “An assurance that tax authorities give to taxpayers on how their tax will be calculated”

Background

- Commission investigations on possible infringement of State Aid rules
 - Ireland (Apple), Netherlands (Starbucks), Luxembourg (Fiat and Amazon)
- Extended to all member states in December 2014
- Also “Luxleaks”: information on 548 Luxembourg rulings on 340 companies leaked – some resulting in very low effective tax rates

What is the value of exchange of rulings?

Provide information to tax authorities in other member states, and to Commission

- May identify possible areas of concern, and audit
- May identify possible infringements of state aid rules
- But limits to action that recipient tax authority can take, as must be compatible with EU law
 - eg. CFC rules can only be applied if arrangements in another member state are “wholly artificial” (Cadbury case)
 - Revision to parent-subsidiary directive required to make it easier to tax a dividend received from an EU affiliate that pays little tax

Further Corporate Tax Transparency

Commission objective: “move to a system on the basis of which the country where a business’ profits are generated is also the country of taxation”

- Would “exposing enterprise to more intense scrutiny on the part of authorities or different stakeholders” contribute to objective?
- Public consultation recently concluded

OECD Action Plan 13 introduces a country-by-country report

- Basic information on revenues, profit, employees, tax and other factors – on a consistent basis across countries

What is the value of country-by country report?

1. If disclosed only to tax authorities

Similar to above

Possibly of more value for combating avoidance involving a non-EU country, since not bound by EU law

2. If disclosed to general public

Useful in broad statistical work – identifying the scale of BEPS, for example

But not very useful in identifying whether a specific company has paid the “right” amount of tax

- Any tax calculation is too complex to second guess on the basis of incomplete information
- Should be very cautious in using such data to name and shame specific companies

Political economy and transparency

Hard to object to greater transparency

But will it help much?

- Will not address fundamental problems in tax system
- May (at the margins) help to combat avoidance, but more easily outside the EU

But an easier target for governments, Commission, OECD and NGOs

4. Co-ordination v Competition between governments

What do governments aim to achieve by competition?

- Attract real economic activity?
- Attract taxable profit?
- Benefit domestic companies by generating competitive advantage?

The UK example

1. Reduction in tax rate from 28% to 20% - and soon to 18%
2. Introduction of patent box to tax royalty income at rate of 10%
3. Generous R&D tax credits
4. Generous treatment of interest deductibility

“The UK’s current interest rules, which do not significantly restrict relief for interest, are considered by businesses as a competitive advantage; other comparable countries tend to have more severe restrictions on such relief.”
5. Generous Controlled Foreign Company (CFC) rules
6. Introduction of Diverted Profits Tax

Is tax competition ever good?

All forms of tax competition aim to benefit one country at the expense of others

- In terms of revenue, investment, etc

“Harmful” tax competition rarely defined

- Usually thought of special treatment of specific groups of taxpayers
- This could upset the “level playing field” for competition between countries
 - But all tax competition can do this

OECD BEPS Project

Complex multi-dimensional game between members (and some non-members)

- Not an exercise in identifying the global optimal tax system
- Not surprising that the result is complex – and lacking much principle

Outside EU, countries could already combat shifting profit to tax havens if they chose to

- But doing so too much could compromise competitive position

Commission's agenda

- Agreement between member states possible when stakes are low
 - Hence focus on transparency: losers will not lose much
 - (includes tax rulings, given state aid investigations)
- Real reform, with gainers and losers much more difficult
 - CCCTB, FTT proposals

5. Incentive compatibility

International tax system can only be stable in the long run if there is no incentive for each country to impose externalities on others

- Competition over rates, or anything else, that affects the location of activity, profit or revenue will affect other countries
- Problem arises because we try to tax income in locations where it is most mobile, and fungible
- In principle: levy tax on profit in location of less mobile activities or income
 - Points to taxation based on residence of, or consumption by, individuals
 - Why do countries not compete over VAT rates?