Inclusive Fiscal Reform: Ensuring Fairness and Transparency in the International Tax System

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OECD
BETTER POLICIES FOR BETTER LIVES

Towards Inclusive Fiscal Reform

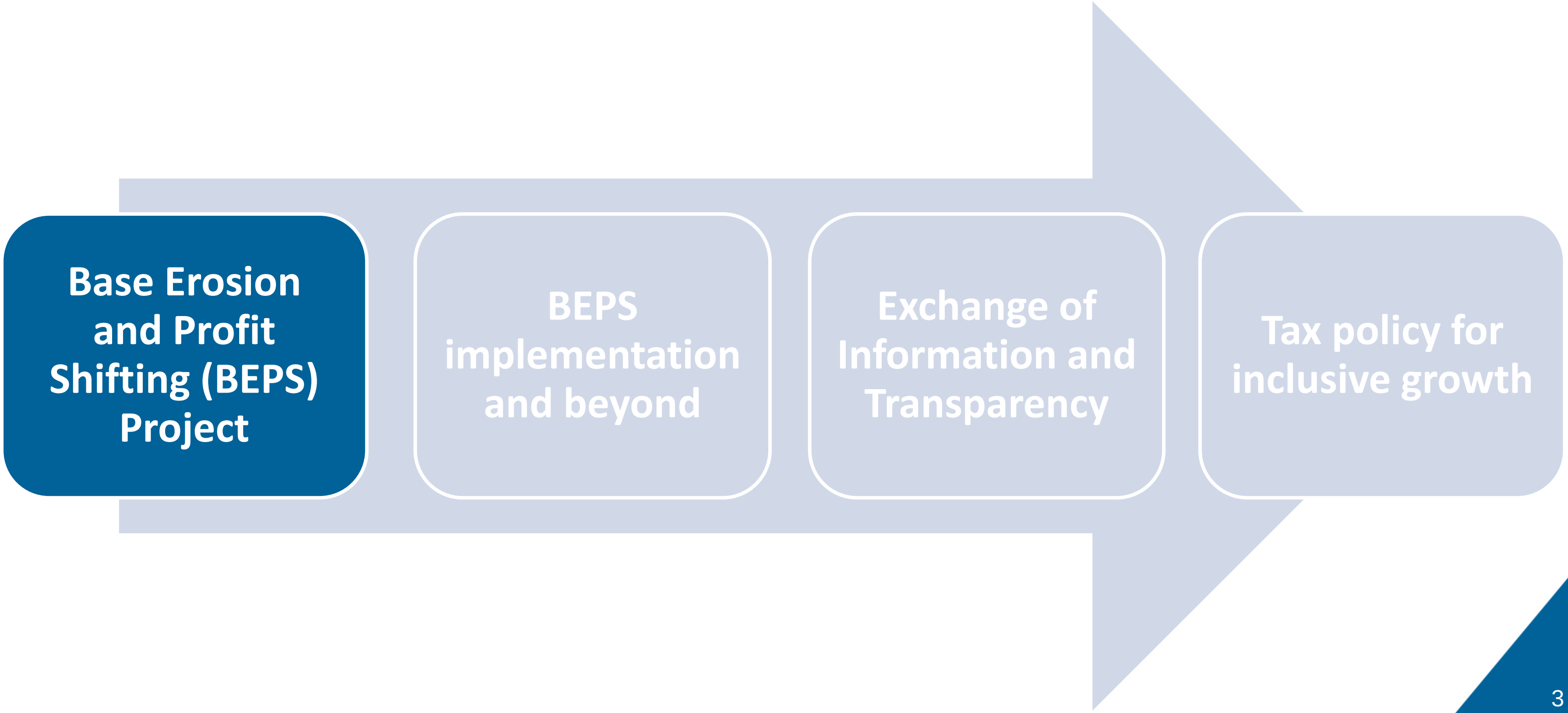
Base Erosion and Profit Shifting (BEPS) Project

BEPS implementation and beyond

Exchange of Information and Transparency

Tax policy for inclusive growth

Towards Inclusive Fiscal Reform

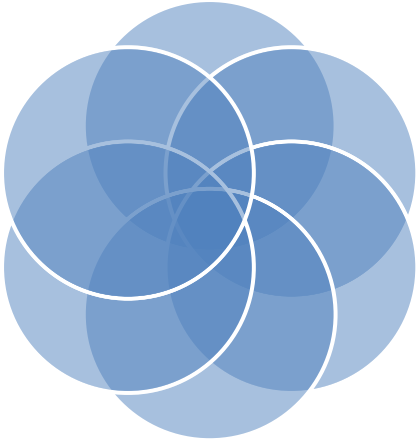


Background to the BEPS Project

Tax sovereignty, tax treaties and globalisation

Need for global action

Double non-taxation & stateless income



Breakdown of international consensus

Digitalisation & growth of intangibles

Crisis, fiscal consolidation & parliamentary inquiries

Background to the BEPS Project

September 2013: G20 Leaders endorsed ambitious and comprehensive BEPS Action Plan with 15 Actions

October 2015: 13 reports delivered just 2 years later

New or reinforced international standards and concrete measures to help countries tackle BEPS

Unparalleled effort - OECD/G20 countries working together on an equal footing with many developing countries

The final BEPS package

Detailed report on measuring and monitoring BEPS

Four minimum standards

Reinforced international standards on tax treaties and transfer pricing

Common approaches and best practices for domestic law measures

Analytical reports with recommendations

- Digital economy and the multilateral instrument

15 Actions around 3 main pillars

Digital Economy (1)

Coherence

- Hybrid Mismatch Arrangements (2)
- CFC Rules (3)
- Interest Deductions (4)
- Harmful Tax Practices (5)*

Substance

- Preventing Tax Treaty Abuse (6)*
- Avoidance of PE Status (7)
- Transfer Pricing Aspects of Intangibles (8)
- Transfer Pricing Risk and Capital (9)
- Transfer Pricing High Risk Transactions (10)

Transparency & Certainty

- Measuring and Monitoring BEPS (11)
- Disclosure Rules (12)
- Transfer Pricing Documentation (13)*
- Dispute Resolution (14)*

Multilateral Instrument (15)

* Minimum standards

Action 11: what do we know about the scale and impact of BEPS?

More than 100 empirical studies report evidence of BEPS

New OECD research finds that global net annual revenue loss of 4-10% of CIT - USD 100-240 billion - at 2014 levels

- As a percentage of tax revenues, this is expected to be higher in developing countries given their greater reliance on corporate tax revenues

BEPS creates many economic distortions

- Effective Tax Rates of large MNEs are lower than similar domestic firms
- Higher profit rate affiliates located in countries with lower statutory tax rates
- Favours intangible investments, companies locating debt in high-tax countries and distorts the location of FDI
- Creates negative tax spillovers across countries

Anti-avoidance rules are effective in preventing BEPS in individual countries, but coordinated measures likely to be more effective

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The Inclusive Framework on BEPS (1)

Call for establishment of a more inclusive framework

- G20 Leaders in Antalya in November 2015 when receiving the final BEPS package

Established in Kyoto in June/July 2016

Now has over 100 members

- Membership now includes over 100 countries and jurisdictions, accounting for about 93% of global GDP

Strong support for the Inclusive Framework at the highest levels

- Widespread support, including from the EU, G20, APEC and BRICS leaders

The Inclusive Framework on BEPS (2)

Monitoring the implementation of the BEPS measures

- Peer review of the minimum standards and monitoring of the implementation of the overall package of measures

Standard setting for remaining BEPS issues

Ongoing monitoring and data gathering aspects of implementation

- Measurement and monitoring of BEPS and BEPS countermeasures (Action 11) – CbC Reporting Data and Corporate Tax Statistics

Implementation support, guidance and toolkits

- Feeds into the toolkit work of the Platform for Tax Collaboration and could potentially impact the remaining BEPS standard setting work

Taxation of the Digital Economy

Main findings on Action 1 Report on Digital Economy

- No unique BEPS issues identified in the digital economy
- But key features (mobility in particular) may exacerbate opportunity to take advantage of BEPS structures
- Digitalisation also poses many broader tax challenges
- A number of options considered

Broader tax challenges

Action 1 report also identified several broader challenges

- **Nexus**: Reduced need for extensive physical presence raises questions about whether current rules are effective
- **Data**: Increased collection and use of data raises questions about appropriate attribution of value from generation of data, and how to characterise supply of data for tax purposes
- **Characterisation**: Uncertainties about characterising income earned through new business models, including cloud computing
- **VAT Collection**: Challenges for collection of VAT in cross-border services, particularly B2C and on low value parcels

Options (1)

Action 1 report outlines a number of options

- Modification of exemptions from Permanent Establishment (PE) status
- New PE standard based on “significant economic presence”
- Withholding Tax on digital transactions
- Equalisation Levy
- VAT Options

Options (2)

Action 1 report outlines a number of options

- None of the three options (highlighted in blue) were recommended. . .

  "because, among other reasons, it is expected that the measures developed in the BEPS Project will have a substantial impact on BEPS issues previously identified in the digital economy, that certain BEPS measures will mitigate some aspects of the broader tax challenges, and that consumption taxes will be levied effectively in the market country."

- However, countries could . . .

  "introduce any of the options in their domestic laws as additional safeguards against BEPS, provided they respect existing treaty obligations, or in their bilateral tax treaties. Adoption as domestic law measures would require further calibration of the options in order to provide additional clarity about the details, as well as some adaptation to ensure consistency with existing international legal commitments."

Task Force on the Digital Economy

2016: Decision that the TFDE should carry out further work

2017: TFDE's mandate was approved by the Inclusive Framework

- Monitor developments in the business use of digital technologies
- Analysis of new business models and determinants of value creation
- Monitor BEPS implementation and analyse data
- Monitor developments in the taxation of the digital economy
- Discuss the suitability of existing tax framework and possible tax policy options

2018: Interim Report

2020: Final Report

Revised timeline under the G20 mandate

Communiqué, G20 Finance Ministers and Central Bank Governors Meeting

Baden-Baden, Germany, 17-18 March 2017

"As part of the BEPS project, we have undertaken a discussion on the implications of digitalisation for taxation in the OECD Task Force on the Digital Economy (TFDE). We will further work on this issue through the TFDE and ask for an interim report by the IMF and WBG Spring Meetings 2018."

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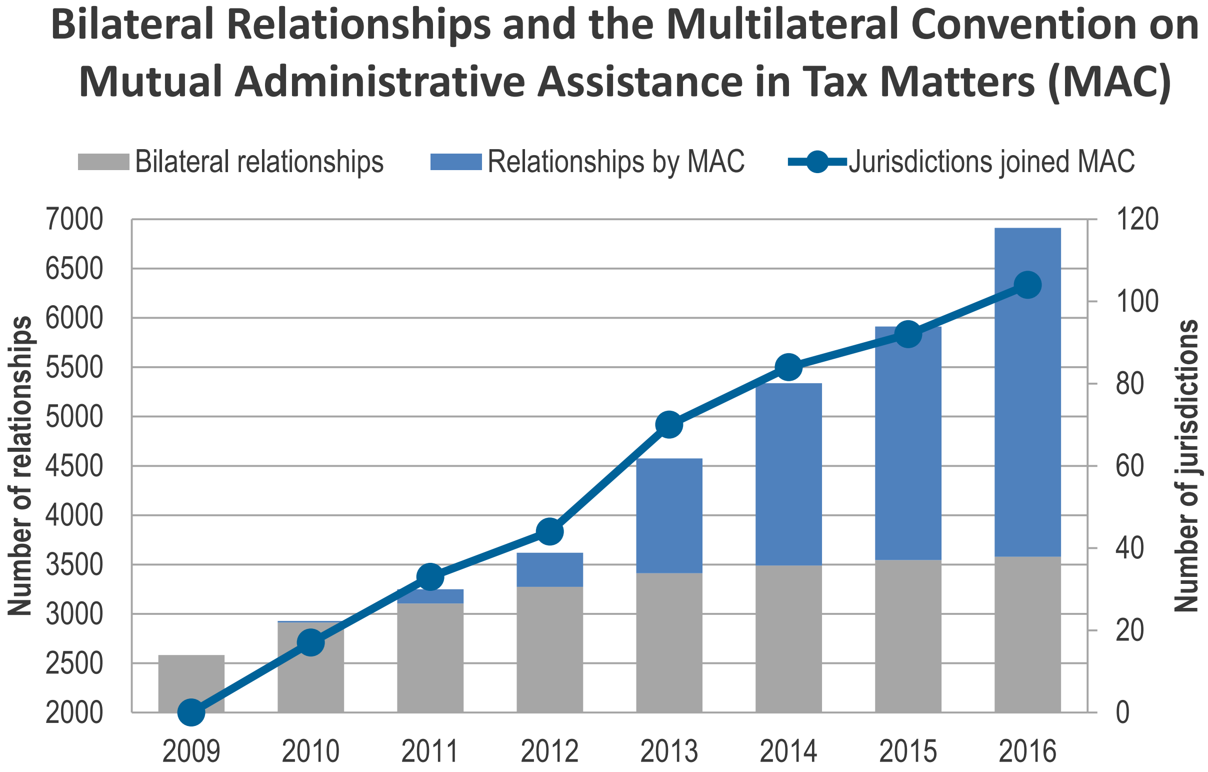
Global Forum and transparency

Global Forum on Transparency and Exchange of Information for Tax Purposes

- April 2009: G20 announces "the era of bank secrecy is over" and the Global Forum was restructured - now consists of **144 members**
- **Exchange of Information on Request** (EOIR). By 2016, **over 250 peer reviews** conducted and **116 jurisdictions rated**
- New rounds of EOIR have commenced against strengthened terms of reference, including availability of **beneficial ownership** (2016-2020)

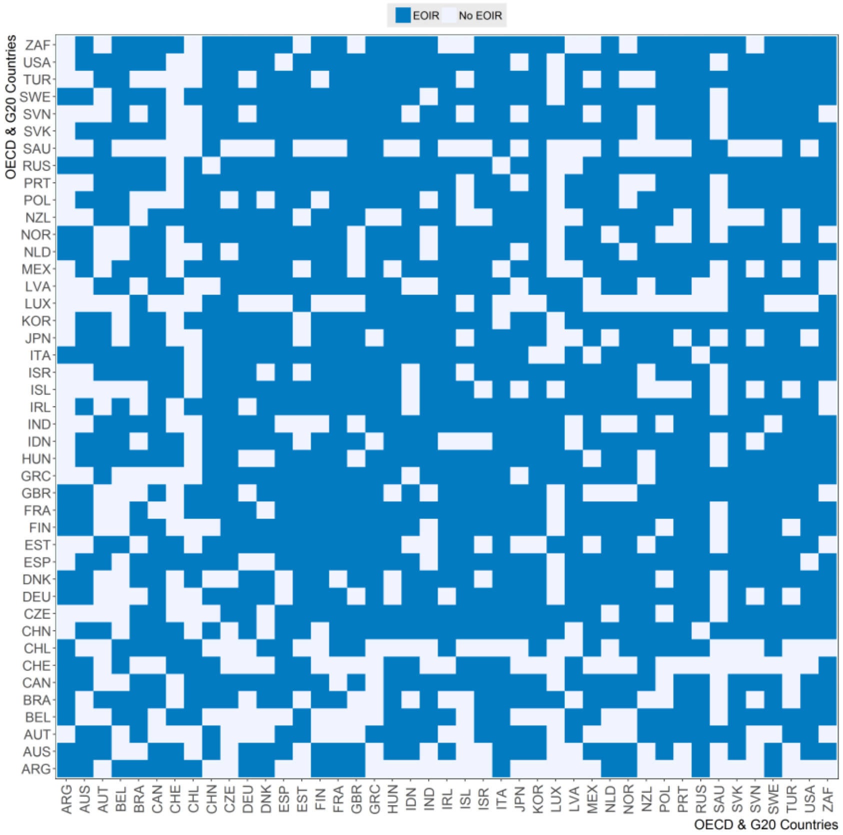
Expanding the exchange of information



- EOI reduces the extent to which individuals and companies are able to use offshore structures to avoid and evade tax.
- Much of the expansion of the EOIR network has come through countries signing the Multilateral Convention on Mutual Administrative Assistance in Tax Matters (MAC) – 110 countries have signed.

The network of EOIR agreements

2009

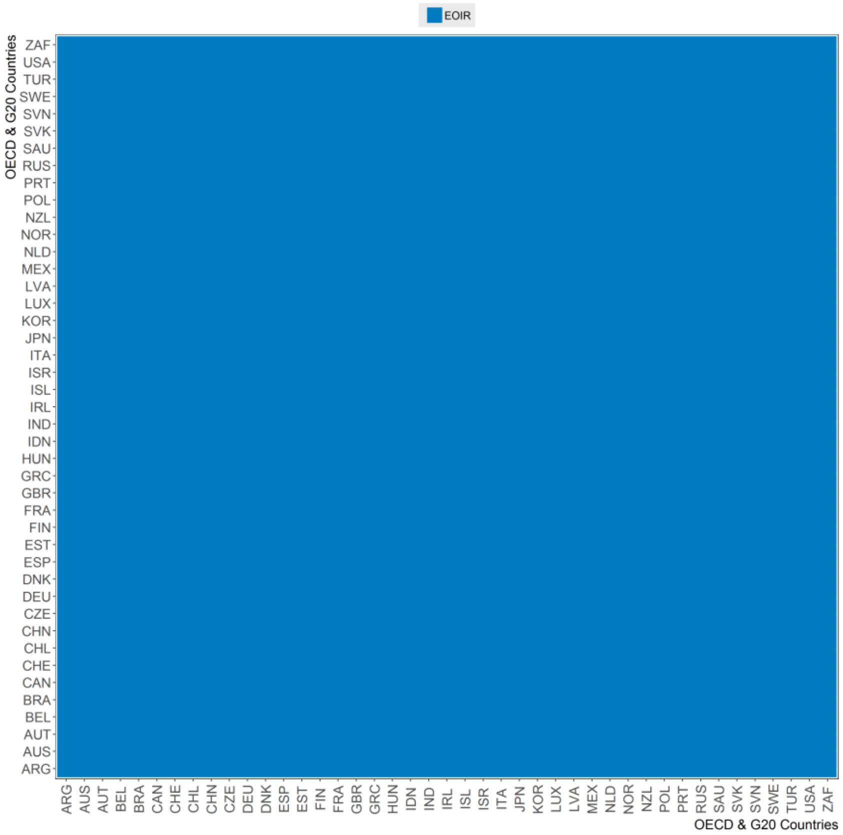


The EOIR relationships amongst OECD and G20 countries in 2009

Data are Preliminary and subject to revision

The network of EOIR agreements

2017

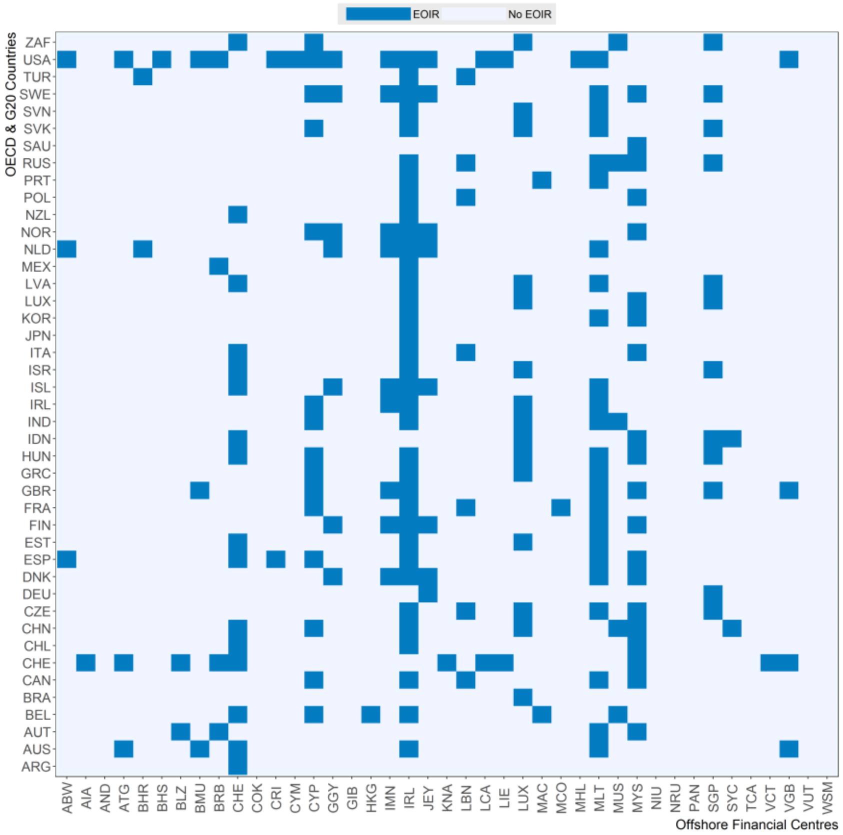


The EOIR relationships amongst OECD and G20 countries in 2017

All OECD and G20 countries now exchange information on request with each other. The network of EOIR agreements has been completed

The network of EOIR agreements

2009

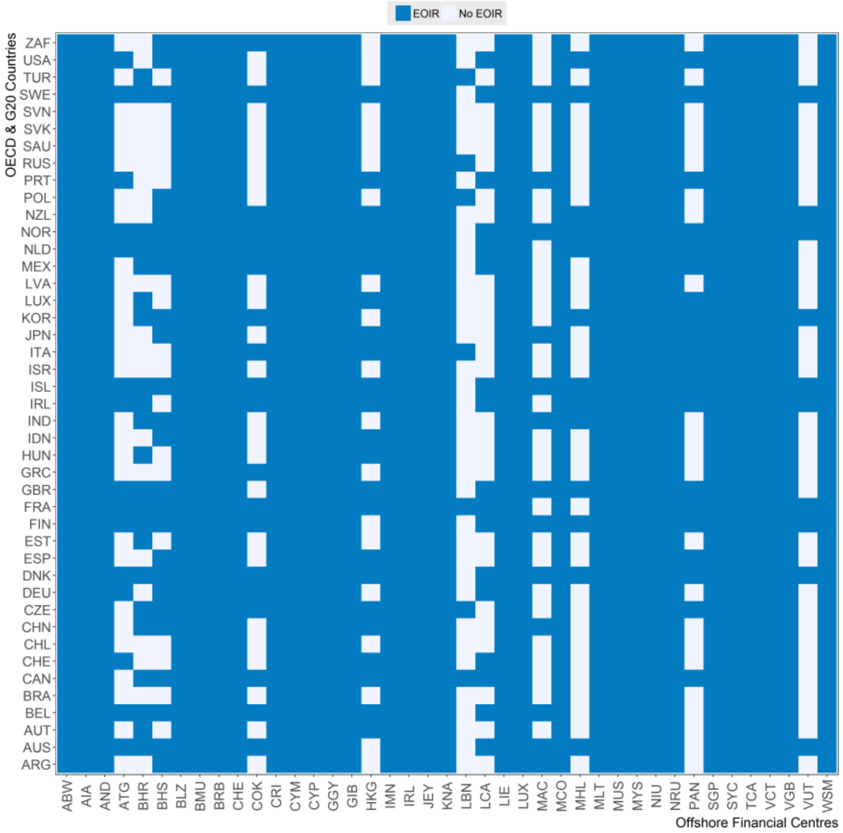


The EOIR relationships between OECD/G20 countries and offshore financial centres* in 2009

*IMF (2000) definition of Offshore Financial Centre used

The network of EOIR agreements

2017



The EOIR relationships between OECD/G20 countries and offshore financial centres* in 2017

In 2009 the network between OECD/G20 countries and OFCs was not very well developed, but it has expanded substantially. However, there are still some offshore jurisdictions that do not exchange information according to the latest data.

*IMF (2000) definition of Offshore Financial Centre used

EOI & Inclusive Fiscal Reform

- Some academic research (e.g. Johannesen and Zucman, 2014) has suggested that when countries sign EOIR agreements, offshore holdings may shift to non-signatory countries – based on 2011 data.
- Other work (Huizinga and Nicodème 2004) suggests that EOI may have limited effectiveness on a regional basis.
- This highlights the importance of the completion of the network of EOIR agreements, for continued multilateral action on EOI and for continued work on beneficial ownership.
- Finally the combination of EOIR and AEOI is especially helpful – but still more work to do to complete AEOI network.

Automatic Exchange of Information

Automatic Exchange of Information (AEOI)

- As the names suggest, EOIR requires a ‘request’ from a tax administration, whereas AEOI occurs ‘automatically’
- In 2014, Global Forum endorsed the Common Reporting Standard (CRS), allowing the AEOI
- **101 countries** have committed to make first exchanges by 2017/18
- AEOI is supported by the Common Transmission System (CTS)
- Estimated that close to **2 000 bilateral exchange relationships** for AEOI to be activated this year with exchanges to begin next September

AEOI & voluntary disclosure initiatives

- While the effect of AEOI will need to be monitored closely once information exchanges begin, there is already some evidence that it is having an impact
- With the automatic exchange of financial account information considered inevitable, many countries have launched voluntary disclosure initiatives ahead of the implementation of AEOI
- More than **500 000 taxpayers** have disclosed offshore assets over the past 8 years, and close to **85 billion euros in additional tax revenue** has been identified as a result of voluntary compliance mechanisms and offshore investigations.*

*OECD (2017), *OECD Secretary-General report to G20 Leaders*, Hamburg, Germany, July 2017

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Tax Policy for Inclusive Growth

Inclusive fiscal reform extends beyond the international tax system and also includes domestic tax policy reform

There are many important linkages between the two

- Increased international cooperation allows countries to protect their tax sovereignty and their tax bases.
- EOI also can reduce tax evasion (which is concentrated among high-earners) and, in doing so, make tax systems fairer.
- **The exchange of information provides new opportunities for the effective taxation of capital on a residence basis**, strengthening the coherence of the tax system.

Key OECD work on inclusive growth

Some of the OECD's recent work on Tax and Inclusive Growth

- *Taxation and Skills* (2017)
- *Tax Design for Inclusive Economic Growth* (2016)
- *The Impact of Tax and Benefit Systems on the Workforce Participation Incentives of Women* (2016)
- *The distributional effects of Energy Taxes* (2015)
- *The distributional effects of Consumption Taxes* (2014)

Tax Design for Inclusive Economic Growth

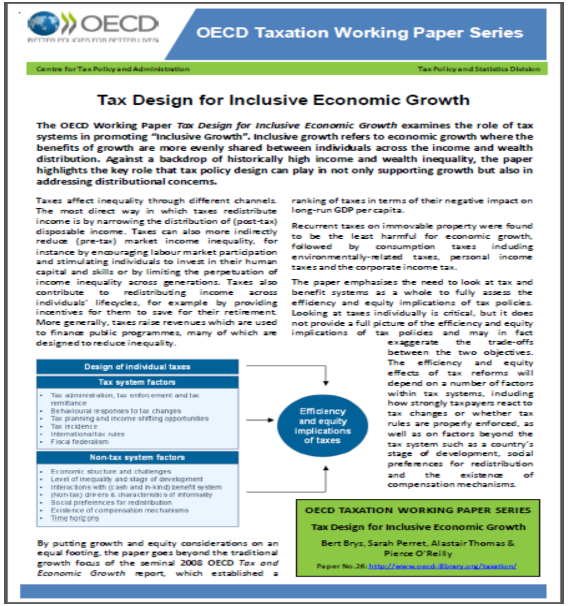
OECD Taxation Paper

Tax Design for Inclusive Economic Growth

Bert Brys, Sarah Perret, Alastair Thomas & Pierce O'Reilly

Paper No.26
OECD Taxation Working Paper series

http://www.oecd-ilibrary.org/taxation/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Tax Design for Inclusive Economic Growth

The OECD Working Paper *Tax Design for Inclusive Economic Growth* examines the role of tax systems in promoting "Inclusive Growth". Inclusive growth refers to economic growth where the benefits of growth are more evenly shared between individuals across the income and wealth distribution. Against a backdrop of historically high income and wealth inequality, the paper highlights the key role that tax policy design can play in not only supporting growth but also in addressing distributional concerns.

Taxes affect inequality through different channels. The most direct way in which taxes redistribute income is by narrowing the distribution of (post-tax) disposable income. Taxes can also more indirectly reduce (pre-tax) market income inequality, for instance by encouraging labour market participation and stimulating individuals to invest in their human capital and skills or by limiting the perpetuation of income inequality across generations. Taxes also contribute to redistributing income across individuals' lifecycles, for example by providing incentives for them to save for their retirement. More generally, taxes raise revenues which are used to finance public programmes, many of which are designed to reduce inequality.

By putting growth and equity considerations on an equal footing, the paper goes beyond the traditional growth focus of the seminal 2008 OECD *Tax and Economic Growth* report, which established a ranking of taxes in terms of their negative impact on long-run GDP per capita.

Recurrent taxes on immovable property were found to be the least harmful for economic growth, followed by consumption taxes including environmentally-related taxes, personal income taxes and the corporate income tax.

The paper emphasises the need to look at tax and benefit systems as a whole to fully assess the efficiency and equity implications of tax policies. Looking at taxes individually is critical, but it does not provide a full picture of the efficiency and equity implications of tax policies and may in fact exaggerate the trade-offs between the two objectives. The efficiency and equity effects of tax reforms will depend on a number of factors within tax systems, including how strongly taxpayers react to tax changes or whether tax rules are properly enforced, as well as on factors beyond the tax system such as a country's stage of development, social preferences for redistribution and the existence of compensation mechanisms.

OECD TAXATION WORKING PAPER SERIES
Tax Design for Inclusive Economic Growth
Bert Brys, Sarah Perret, Alastair Thomas & Pierce O'Reilly
Paper No.26: http://www.oecd-ilibrary.org/taxation/

Tax policy affects inequality

Tax revenues finance expenditure which may reduce inequality

- Most redistribution occurs through transfers

Taxes can reduce disposable income inequality

- PIT progressivity is the key tool to narrow the distribution of disposable income

Taxes can reduce market income inequality

- Taxes affect pre-tax opportunities and behaviours, e.g. tax and skills

The tax system can redistribute income across the lifecycle

- Intra-personal as opposed to inter-personal redistribution, e.g. SSCs to finance future benefits

Approach of the paper

Tax-by-tax assessment + Systems approach = Tax policy principles for inclusive growth

A systems approach

Design of individual taxes

Tax system factors

- Tax administration and tax enforcement
- Tax remittance
- Behavioural responses to tax changes
- Tax planning and income shifting
- Tax incidence
- International tax rules

Non-tax system factors

- Economic structure and challenges
- Interactions with benefit systems
- (Non-tax) drivers & characteristics of informality
- Social preferences for redistribution
- Existence of compensation mechanisms
- Time horizons

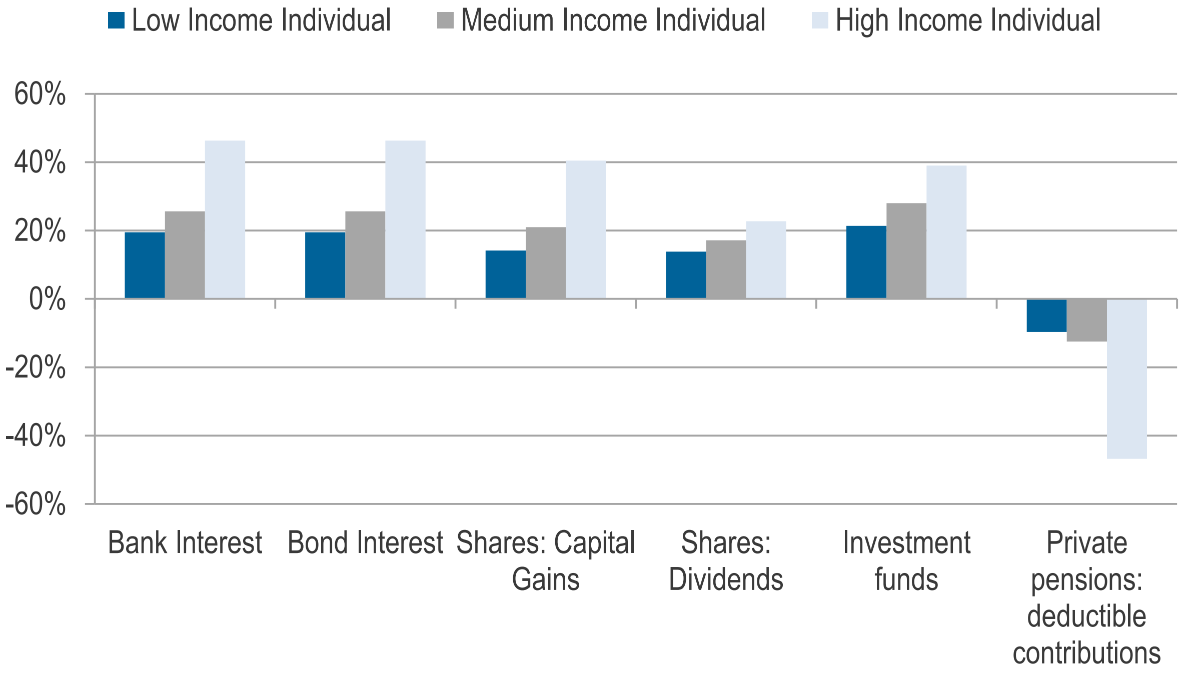
Efficiency and equity implications of taxes

Inclusive fiscal reform design principles

1 Broadening tax bases	2 Strengthening tax system progressivity	3 Affecting pre-tax behaviours & opportunities	4 Enhancing tax administration and policy
Keep bases broad and rates low	Equitable taxation of capital income	Provide incentives for formalisation	Increase value for tax money
Remove inequitable tax expenditures	Compensate losers of reforms	Promote equity of market income	Monitor income & wealth distribution
Broadening social security financing	Strengthen link between lifetime taxes & benefits	Align private & social costs and returns	Fight against tax avoidance & evasion

How progressive is savings taxation?

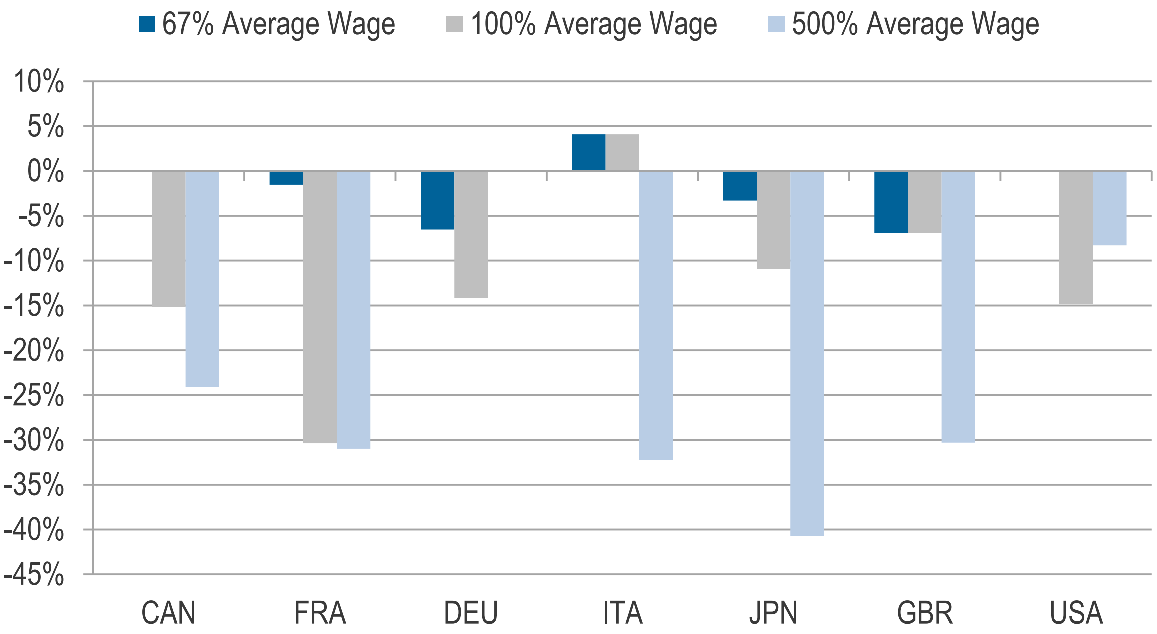
Effective tax rates on savings by asset type and income level, G7 averages



- The taxation of savings is broadly progressive, except for private pensions.
- Tax rates are nonetheless usually below those for labour income - making tax systems less progressive. High earners have more capital income.
- Assets favoured by those on higher incomes are often taxed at lower rates leading to arbitrage opportunities.

Reforming regressive tax expenditures (1)

Effective tax rates on savings with tax-deductible private pension contributions

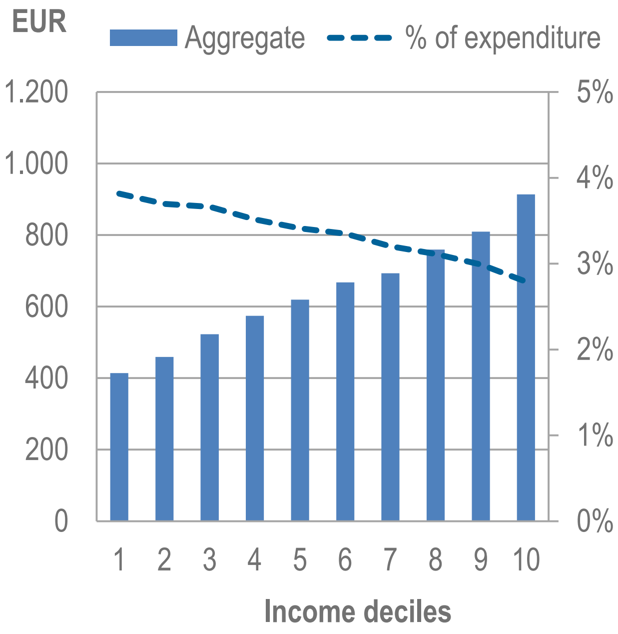


- Tax expenditures for pensions often result in ETRs that are negative, and regressive.
- They can include the mortgage interest deduction, and pension deductions.
- Capping these provisions (or providing refundable tax credits) could be an inclusive growth oriented policy measure.
- Taxation of capital income should be combined with strengthened recurrent property taxation.

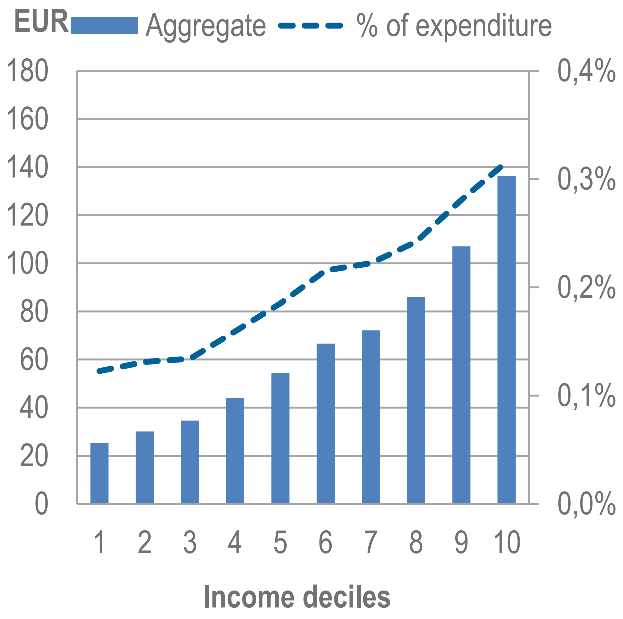
Reforming regressive tax expenditures (2)

All-country average of value of consumption tax expenditures per household

From all VAT reduced rates



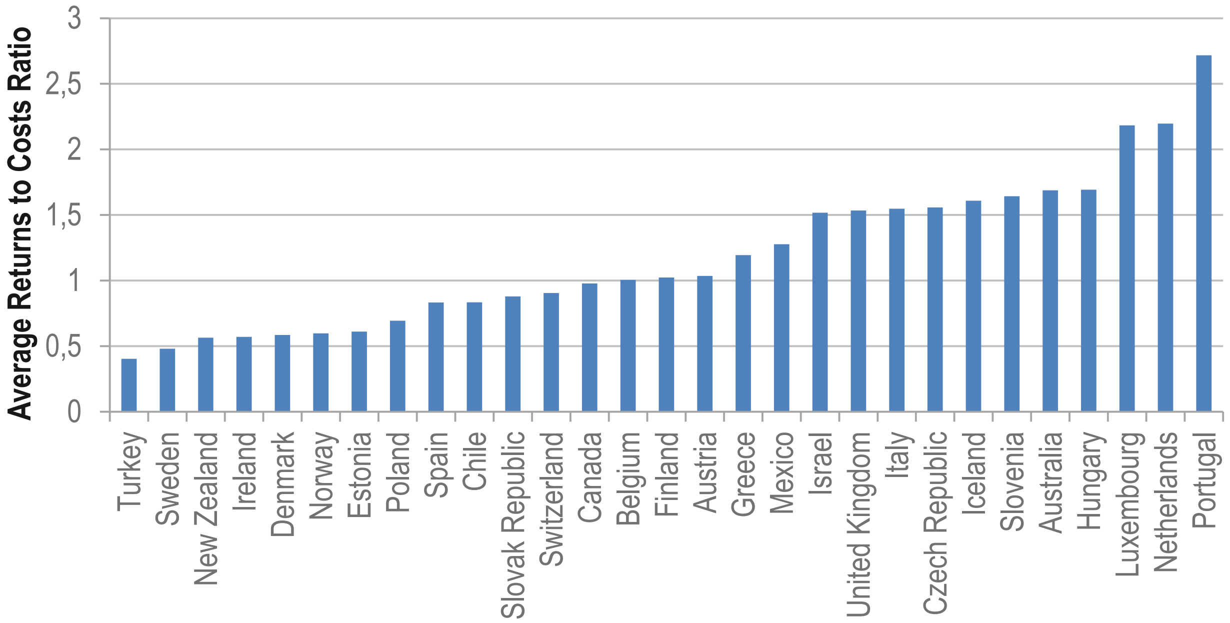
From reduced rates on restaurant food



- Use of reduced VAT rates are intended to support those on low incomes.
- But these reduced rates often provide larger benefits to those on higher incomes.

Aligning private & social costs/returns

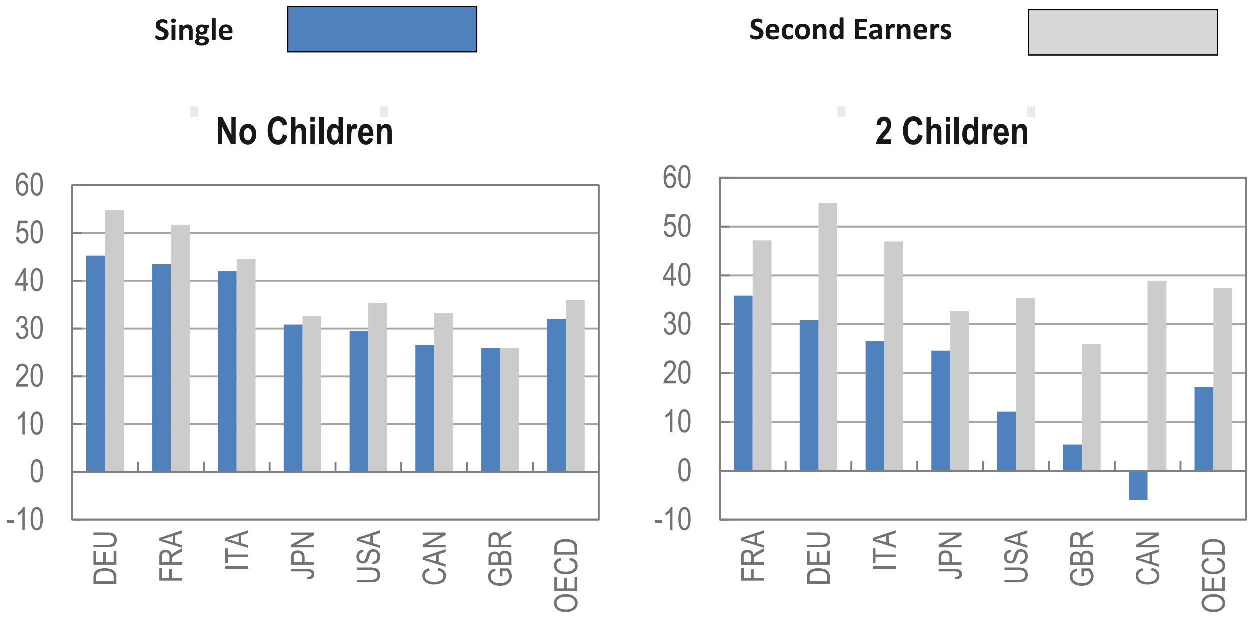
The ratio of government returns to government costs of investment in tertiary education



- Skills investments yield substantial returns to governments.
- Taxation of human capital as well as physical capital needs to be given more attention.
- Skills investments raise growth and equality at the same time.

Incentivising labour market participation

Average tax wedge as a percentage of total labour costs, 2015, single and second earner at 67% of the average wage



- Second earners are often taxed at high marginal rates relative to primary earners, due to family-based-taxation, spousal allowances and family based benefits.
- Second earners often have particularly strong negative responses to income taxation.

Inclusive growth: future publications

Forthcoming OECD publications on Tax and Inclusive Growth

- ***The Taxation of Household Savings*** (early 2018)
  - The study will focus on the taxation of capital income in response to changes in inequality and increased exchange of tax information
- ***Net Wealth Taxes*** (2018)
  - The study will focus on the experiences of OECD countries with net wealth taxes

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