



OECD Taxation Working Papers No. 2

What is a "Competitive" Tax System?

Stephen Matthews

<https://dx.doi.org/10.1787/5kg3h0vmd4kj-en>

OECD CENTRE FOR TAX POLICY AND ADMINISTRATION

OECD TAXATION WORKING PAPERS SERIES

This series is designed to make available to a wider readership selected studies drawing on the work of the OECD Centre for Tax Policy and Administration. Authorship is usually collective, but principal writers are named. The papers are generally available only in their original language (English or French) with a short summary available in the other.

The opinions expressed and arguments employed in these papers are the sole responsibility of the author(s) and do not necessarily reflect those of the OECD or of the governments of its member countries.

Comments on the series are welcome, and should be sent to either ctp.contact@oecd.org or the Centre for Tax Policy and Administration, 2, rue André Pascal, 75775 PARIS CEDEX 16, France.

Applications for permission to reproduce or translate all, or part of, this material should be sent to OECD Publishing, rights@oecd.org or by fax 33 1 45 24 99 30.

Copyright OECD 2011

FOREWORD

This paper was prepared for the High Level Conference on “Challenges in Designing Competitive Tax Systems”, which took place at the OECD on 30 June 2011. This conference was held within the framework of the OECD 50th Anniversary. At this conference, ministers and senior tax policy officials reviewed trends in tax reform over 50 years, discussed emerging pressures on competitiveness of tax systems and how to achieve successful reforms in the 21st century.

The paper considers how tax policy and administration impact on an economy’s competitiveness and reviews various measures of ‘tax competitiveness’.

WHAT IS A “COMPETITIVE” TAX SYSTEM?

Stephen Matthews¹

A. Introduction

1. Statements about the importance of tax systems being ‘competitive’ are often made by business, politicians, lobbyists and other commentators, but what does this term mean?

2. In everyday usage ‘competitive’ is a relative concept. When applied to a business, it would mean that the firm in question is able to produce its output at the same or lower cost than other firms in the same line of business, or that it has some other advantage over them such as the quality of its product. In most industries a competitive firm would (as a result of its cost or other advantages over its rivals) be able to earn returns in excess of its cost of capital.

3. It is more difficult conceptually to apply the term ‘competitive’ to an economy as a whole rather than a particular business. An economy is made up of many different firms (plus extensive public sector provision of services). Moreover the structure of its production and the pattern of its trade will depend on its *comparative* advantage relative to other economies.² Specialisation in line with comparative advantage increases production efficiency and raises living standards.

4. For a typical advanced economy (where natural resources and primary products make up a relatively small part of domestic output) there are likely to be strong links between the competitiveness of its firms and the overall levels of productivity and living standards that the country is able to sustain. Individual firms may then be ‘competitive’ internationally (in the sense of having a cost or other advantage relative to their foreign rivals, given the exchange rate, etc); and if a firm is not competitive, then national output and income are likely to be higher if the resources it would have used are redeployed to another line of business where profit opportunities are better.

5. Most of the drivers of the competitiveness of firms lie within the domestic economy. Thus the World Economic Forum, for instance, in its Global Competitiveness Report defines ‘competitiveness’ as ‘the set of institutions, policies and factors that determine the level of productivity of a country’. The level of productivity in turn sets the sustainable level of living standards. The Global Competitiveness Report

¹ Chief Tax Economist, Centre for Tax Policy and Administration, OECD. Email: Stephen.Matthews@oecd.org. The author gratefully acknowledges the input of colleagues in CTPA and country Delegates to the Working Party on Tax Policy and Statistics in commenting on an earlier draft of this paper. The annex on the Administrative Dimension was prepared by Richard Highfield, Senior Advisor on Tax Administration, and Jeffrey Owens, Director of CTPA

² Even if its firms operate with higher levels of productivity than their foreign rivals, an economy cannot have a competitive advantage in everything, but will specialise where that competitive advantage is greatest. The higher overall levels of productivity translate (via a higher real exchange rate) into improved terms of trade and higher living standards.

weights together data pertinent to 12 ‘pillars of competitiveness’: institutions, infrastructure, macroeconomic environment, health and primary education, higher education and training, goods market efficiency, labour market efficiency, financial market development, technological readiness, market size, business sophistication and innovation.

6. There are likely to be significant overlaps and interactions between these ‘pillars’ and views may differ on precisely how they translate into increased production efficiency and growth potential. However, one approach to examining the impact of tax on ‘competitiveness’ is to consider how tax policy and administration impact on the various ‘pillars’ and hence productivity, etc. In practice, most taxes (not just the corporate income tax) can have an impact on competitiveness, as section B below indicates. In practice, the underlying themes arising from taking a ‘competitiveness’ perspective are very similar to those explored in OECD work on Tax and Economic Growth (OECD 2010a) and the Tax Policy Brief on Tax Policy Reform and Fiscal Consolidation (OECD 2010b).

7. However, in considering how tax policy can help to generate economic growth and prosperity, each country’s tax system cannot be considered in isolation. In open economies where capital is mobile across boundaries and multinational enterprises play an increasing role in international trade and investment, tax regimes and tax rates can potentially have a significant influence on decisions about the location of production and investment. Section C accordingly explores notions of ‘international tax competitiveness’ and how they interact with other desiderata for tax regimes: raising sufficient revenues, fairness, economic efficiency, etc. Section D discusses further some of the problems of measuring international tax ‘competitiveness’.

8. Section E then sets out a few concluding observations on the implications for tax policy and the role that common principles (e.g. the OECD Model) and economic cooperation can potentially play.

B. Pillars of competitiveness: The Impact of Tax Policy and Administration

9. The following paragraphs focus on the ‘pillars’ identified in the Global Competitiveness Report that are most likely to be directly affected by tax policy and/ or administration.

Institutions

10. A sound and fair legal and administrative framework (within which individuals, firms and governments interact to generate income and wealth in the economy) has a strong bearing on competitiveness and growth. Investment decisions for instance will be influenced by property rights, attitudes to markets and levels of trust. Tax policy and administration can contribute to a competitive economy in a number of ways under this pillar, including:

- Raising tax revenues in a way that is broadly accepted as fair is more likely to achieve high levels of (largely) voluntary compliance
- Good administration that is effective in deterring evasion reinforces social cohesion and ensures no unfair advantage accrues to businesses that evade tax
- Similarly, tax administration that is not open to corruption and that implements tax law consistently and impartially make the tax regime predictable and reduce the extent to which it might discourage investment
- Efficiency in tax administration reduces the amount of an economy’s resources that have to be devoted to revenue collection

- Low compliance costs and burdens on business reduce the time that taxpayers have to spend on tax compliance – time and effort that could otherwise be spent on creating income and wealth
- Tax policy making that is evidence-based and transparent, with publication of the revenue forgone from tax expenditures and periodic reviews of their cost-effectiveness, estimates of the revenue effects of tax measures proposed in the budget, etc

11. Another important institutional factor for a country's competitiveness is corporate governance: having businesses that are run honestly and follow strong ethical practices in their dealings with government on tax matters.

Macroeconomic environment

12. A core objective of tax policy must be to raise sufficient tax revenues to finance public expenditure while maintaining sustainable budget deficits and public debt ratios. Correspondingly, any tax cuts have to be 'paid for'. The overall economic impact of a tax reform package and of its financing hence need to be considered together.

13. In addition, the macroeconomic environment influences the extent to which the tax regime reduces economic efficiency and growth prospects. Low and stable inflation rates for instance reduce the distortionary effects on saving and investment of conventional income taxes based on historic cost accounting. Stability of the macroeconomic environment also enables stability in tax rates and regimes; and where the tax consequences of business decisions and/ or household savings' choices are predictable the tax regime should lead to less distortion of the market signals to businesses and households that guide their saving and investment decisions.

Higher education and training

14. While primary and secondary education is generally compulsory and state funded, higher education, vocational and on-the-job training usually involve more private sector choice and finance. Tax regimes thus need to be designed so that they do not distort such choices and, moreover, take account of the various market imperfections and spillovers that often arise in this area.

Good market efficiency

15. Growth-oriented tax regimes distort market signals as little as possible, and avoid discouraging the supply of entrepreneurship, investment and skills. Tax policies need to go with the grain of competition in ensuring that it is the most efficient firms, producing the goods and services demanded by the market, which thrive; and at the same time support the redeployment of resources into firms and industries where the reward they can earn is higher.

16. Tax systems will in general be less distortive if they use a broad base, e.g. by applying the standard VAT/GST rate to all consumption expenditure, as this reduces the extent that tax distorts choices and enables tax rates to be lower than otherwise, so disincentive effects are reduced. Similarly broadening Personal (and Corporate) Income Tax bases by reducing tax expenditures would allow lower marginal tax rates; and the distortionary effects of these taxes depends primarily on marginal rates. (The international dimension to government decisions about what to tax and the design of tax regimes is discussed further in section C.)

17. A significant exception to the general rule that taxes should distort market prices as little as possible can arise where those prices do not reflect costs (such as environmental damage) or benefits (such

as spillovers from one firm's R&D to other firms). In such cases a well-designed tax to 'correct externalities' would improve economic efficiency and incentives.

Labour market efficiency

18. On average in OECD countries revenues from personal income tax (PIT) and social security contributions (SSCs) make up about half of total revenues. This implies that tax rates can be high and have potentially significant disincentive effects. The PIT is also the tax that is most closely tailored to reflect ability to pay and it plays a significant role in the redistribution of gross (pre-tax) incomes. Governments thus have to make important judgments about the trade-offs between efficiency and fairness. Both can be important for competitiveness. Social cohesion associated with widely-held views that the tax regime is fair can for instance improve the functioning of institutions, goods and labour markets.

19. Empirical evidence suggests that some labour supply decisions are more responsive to tax (dis)incentives than others, e.g. those of second earners, the low-skilled/ low paid, older workers. Tax reforms that promote their labour market participation could thus increase labour supply and promote inclusiveness – another rider to focusing on productivity/ competitiveness per se.

20. Labour market efficiency also involves the cost and speed with which labour can be shifted from one economic activity to another, as economies adjust to the opportunities and challenges of globalisation, new technologies and the aftermath of (macro) economic shocks. There can be significant interactions between labour market regulations, minimum wage rates and the tax/ benefit regime impacting on this flexibility.

Financial market development

21. A sound financial sector that intermediates efficiently between savers and investors is important in ensuring that businesses and entrepreneurs (especially those developing new products and technologies) have adequate access to funds and that the investment opportunities that yield the highest expected (pre-tax) returns are undertaken. It is correspondingly desirable that tax should not distort decisions on how to finance investment, including the choice between debt and equity.

Market size

22. Trade generally has a positive effect on growth, especially for countries with small domestic markets. Tax policies can support wider markets by removing tax obstacles to trade, e.g. the OECD International VAT Guidelines that are being developed to prevent double taxation (or non-taxation).

Business sophistication

23. This includes the quality of individual firms' production, innovation and marketing strategies, as well as the growth of 'clusters' and other networks. An associated challenge for the tax authorities can be that firms' (particularly MNEs) tax planning strategies also develop in sophistication and frequently exploit mismatches between national tax systems.

Technological readiness and innovation

24. Technological readiness refers to the ability of economies to adapt existing technologies and innovation to the development and application of new technologies and products. Successful R&D is clearly crucial. There is some evidence that a favourable tax regime for R&D increases the amount of such expenditure, but less clear evidence on the best design of any tax relief or the appropriate degree of tax privilege.

C. International Tax Competitiveness

25. Liberalisation of trade and capital markets has been an important component of ‘globalisation’. This process has embraced both OECD countries (which have taken further steps in this direction) and emerging economies (notably the BRICs). The resulting increased competition and pressures to produce where profitability is greatest have been accompanied (on the supply of funds side) by much greater mobility of capital. Both foreign direct investment (FDI) and portfolio investment have grown massively in relation to GDP. In the OECD area the stock of outward FDI in relation to GDP increased from 10 per cent in 1990 to 39 per cent in 2009; and the corresponding figures for inward FDI were a rise from 8 per cent to 31 per cent of GDP. Inward and outward portfolio equity investment grew from around 1 per cent of GDP in 1990 to around 7 percent.

26. These trends have had significant implications for tax policy, as cross-border investors will generally be looking to maximise their post-tax not their pre-tax returns. Countries may feel that they are increasingly in a position of competing as a location for FDI and, as a result, under pressure to reduce taxes on the return on investment, particularly their corporate income tax rate. Even an investment with an expected return comfortably in excess of a firm’s cost of capital may not go ahead if an even larger return could be achieved in another country through tax rates being lower. In practice, the range of empirical estimates of the responsiveness of FDI to corporate tax rates is quite wide and this makes clear cut conclusions difficult. Nevertheless, this elasticity appears to have increased over time and international competition for FDI thus reinforces the wider ‘competitiveness’ arguments discussed in the previous section for a tax regime that fosters a good climate for investment and innovation.

27. A second, but related, challenge for tax policy from globalisation is the greater ease with which business (especially MNEs) can engage in aggressive tax planning activities, including by:

- moving (‘stripping’) earnings from one (higher tax) country to another (lower tax) country through e.g. internal group leverage such as financing subsidiaries in high tax countries primarily with debt;
- profit shifting through transfer mis-pricing, i.e. by setting prices for intra-group transactions which are inconsistent with what unrelated parties would do; and
- taking advantage of differences between tax regimes, e.g. through the use of ‘hybrid’ instruments (which may lead to a deduction in one jurisdiction without corresponding taxation in another jurisdiction).

28. Countries may thus feel that they are competing not only for investment, but also for taxable profits. The tax base of a MNE’s home country and that of host countries can be at risk. Especially if the home country is a relatively high tax country, its taxable profits may be reduced dramatically through aggressive tax planning techniques, particularly in the area of intangibles.

29. In deciding how to respond, governments have to take a systemic view of the tax regime and of how, in particular, they want to tax capital income. Corporate income taxes potentially fulfil a number of valuable functions such as taxing profits on an accruals basis, so that individuals cannot use corporations as a tax shelter; providing a way of taxing source country profits accruing to overseas investors; and implementing a form of withholding tax on the capital income from equities held by resident investors. Collecting tax on profits at the corporate level is likely to be much less cumbersome than taxing individual shareholders and, when domestic companies were owned almost entirely by resident investors, such a regime was likely to be administratively both fair and efficient. This is arguably still the case in a large

country like the US where nearly 90% of equity in US corporations is US-owned, but is much less likely to be the case in small open economies.

30. In lobbying governments about taxes, businesses tend to focus on the CIT regime, as this is generally a tax burden on all their shareholders whether domestic or foreign, exempt or taxpaying.³ And for MNEs a ‘competitive’ CIT regime appears to be seen as one under which the tax rate that they face in a country is no less favourable than that facing both domestic companies in the host country and the subsidiaries of MNEs from other home countries.

31. This ‘tax rate’ depends in practice on a range of factors including the statutory CIT rate, the tax base (notably depreciation of assets for tax purposes), the type of double taxation relief operated by the home country, the opportunities for aggressive tax planning and the extent to which a business exploits them. The last factor means that the effective tax rate faced by a business does not just depend on the host country’s tax legislation – it is to some extent linked to the tax legislation of the other countries in which the business operates and the degree to which the business chooses to exploit differences between the regimes.

32. Thus even if the narrow business lobby interpretation of a ‘competitive’ tax regime were accepted, a country that wanted to compare its regime with that of other jurisdictions would need to look not just at statutory tax rates, but also at effective tax rates that allow also for differences in the tax base such as the rates of depreciation of assets permitted for tax purposes. But even this estimated effective tax rate might not be the actual effective tax rate when aggressive tax planning is not effectively countered. Ideally, international comparisons of effective tax rates ought therefore to take account of tax planning and avoidance.

33. Business lobbies seek to put pressure on governments for support in the name of ‘competitiveness’ in many areas of international trade and investment. As a general rule, though, resources devoted to providing export subsidies or other support mean that an economy ends up producing less than otherwise, given the additional (distortionary) taxes that have to be levied on the rest of the economy to finance the support. Similar arguments can be made in relation to any implicit support for FDI (whether inward or outward) through lower effective tax rates on the return on such investment than a purely domestic investment. The forgone revenues have to be made up through higher taxes on the rest of the economy.

34. On the other hand, where capital is highly mobile internationally and an economy is small in relation to international capital markets, it is arguable that, while the formal incidence of the corporate income tax may be on the owners of capital, its effective incidence is likely to be on less mobile factors such as labour. At the limit, source taxation of capital income could mean investors would choose to invest in another country (where taxes were lower) and the host country would have a lower capital stock, a lower capital/labour ratio and lower real wages. In practice capital is generally not quite that mobile (except perhaps money and bond markets), but governments still face difficult choices about how far they should tax corporate earnings (especially given the uncertainty already noted above about how responsive FDI is to tax rates) and about whether to accept MNEs being able to achieve a lower effective tax rate than domestic firms by exploiting differences among tax systems.

35. These choices involve making judgements about what are the most significant distortions that will mean output is lower than it could be and how far additional investment will mean that domestic incomes are higher than they would otherwise be. At the same time the principle of ‘ability to pay’ would

³ Exception may be some forms of imputation regime

point to taxing capital as well as labour incomes, posing the question of how is this to be achieved if CIT rates are cut (or MNEs are tacitly allowed to reduce the effective tax rate they face through tax planning).

36. Although tax policy decisions about rates of CIT and approaches to aggressive tax planning are central to the impact that tax has on the competitiveness of an economy, the way the tax system is administered matters as well. In making decisions about future investment, businesses value certainty about the tax regime that will apply to the returns they expect to earn. Tax systems that are not administered in a consistent and even handed way, or that impose high compliance costs, are likely to impede competitiveness. Instability in the tax system, resulting from frequent changes in policy or design, will also increase levels of uncertainty in the minds of investors. For a country to be regarded as a ‘good place to do business’ many aspects of its tax systems are likely to be pertinent, not just its business tax regime (see also the Annex).

D. Can international tax competitiveness be measured?

37. The discussion in section B above of how tax policies and administration influence the ‘pillars’ of competitiveness used in constructing the Global Competitiveness Indices of the World Economic Forum was largely descriptive and it is tempting therefore to look for more quantitative measures of how one country’s tax regime compares with others’. As already discussed, though, statutory tax rates are only part of the story. Account should also be taken of not only differences in the tax bases, but also the impact of (aggressive) tax planning. Measures of the tax wedge between the pre-and post-tax returns on hypothetical investment projects can capture such effects and provide a useful indicator of the extent to which taxation raises the cost capital and distorts investment choices. Such figuring can also take account of other taxes (as well as CIT) that impact on business investment decisions such as recurrent taxes on business property and capital. However, it is inevitably somewhat stylised. It also does not take account of administrative and compliance costs.

38. Some limited international comparisons can be (and have been) made of the size of the compliance cost burdens imposed on firms in meeting their tax obligations (including those arising from deducting at source personal income tax liabilities and employee social security contribution on earnings and then remitting them to the tax authorities). However, ensuring that like is compared with like is problematic.

39. This is a fortiori the case for measures that seek to combine both tax and administrative burdens based on a ‘standard’ firm in different countries (as with the Doing Business reports prepared by the World Bank). The chosen hypothetical firm and business scenario are unlikely to be representative of the actual situation in different countries. Methodological difficulties can include assuming that responsibility for remitting a tax is the same as effective incidence and ignoring all tax planning which (as already noted) is rife and reduces effective tax rates. Measurement of administrative burdens, being based on generalisations from particular cases and activities, does not give a complete picture of the end to end process of tax administration and compliance. As a result of such methodological problems ‘Doing Business’ and similar indicators can be very difficult to interpret; and changes to tax policy or administration that look to be cost effective ways of improving a country’s ranking in such league tables may not actually be desirable, viewed from a wider tax policy perspective.

40. In addition, to the extent that the provision of public services which enhance the business climate and competitiveness (in the broader sense used by the Global Economic Forum) is positively correlated with tax revenue, one cannot argue that lower taxes increase competitiveness. In any case, it is desirable to take a systemic approach to tax policy and administration. There may well be scope, for instance, to characterise income as corporate or personal (depending on which is the more favourable regime). Thus the statutory corporate income tax rate cannot simply be set at low levels that are judged to be

‘competitive’: it has to have a coherent relationship with the rest of the regime so that significant arbitrage and distortions are prevented.

E. Some concluding observations

41. As discussed above, notably in section B, an economy’s ‘competitiveness’ and its ability to achieve high and growing productivity and economic prosperity are likely to be driven primarily by domestic factors. If these mean that it is able to generate plentiful investment opportunities with high (pre-tax) returns, then its tax rate (if broadly in line with other similar economies) may not have much effect on levels of investment. In other words, if the competitive pillars of an economy are strong, it is generally more able to impose corporate income tax without discouraging investment. This highlights the importance of governments spending their tax revenues efficiently in areas that strengthen the fundamentals of competitiveness.

42. Conversely, low CIT rates may not be able to compensate for weaknesses in the competitiveness ‘pillars’. (A small country with a low CIT rate and weak anti-avoidance regime could, though, attract sufficient additional taxable profits to its jurisdiction to offset the loss of CIT revenues on profits from domestic investment, even if this advantage might prove precarious if other countries were to adopt more effective measures against profit shifting and other avoidance.)

43. Tax policy and administration to promote ‘competitiveness’ thus need primarily to be directed at strengthening the pillars outlined in section B. This points to pursuing the sort of policy recommendations that emerged from OECD work on Tax and Growth: shifting the balance of taxation more toward broad based taxes on consumption and recurrent taxes on residential property, broadening tax bases, improving compliance, etc.

44. Nevertheless, in a world with high levels of capital mobility, countries cannot ignore the potential effects on investment of how their tax rates compare with other countries’. However, as discussed above, the relevant tax rate is not just the statutory CIT rate but effective rates that also take account of other aspects of the tax base and the likely nature and scale of aggressive tax planning. In addition, other taxes (e.g. on business property), compliance costs, quality of infrastructure, etc are likely to be important elements of a country’s ability to provide a business friendly tax administration.

45. At the same time, countries will want to protect their tax bases. They can do this unilaterally to some degree, e.g. by the regime they operate for the passive income of controlled foreign companies, for the deduction of interest and other expenses or for double taxation relief. The effectiveness of such measures would be strengthened if international cooperation is enhanced, e.g. through exchange of details of aggressive tax planning trends and patterns, the detection and the response strategies used (from both a policy and compliance perspective), the use of joint audits, and the development of additional guidance such as on the application of the arm’s length principle to intangibles. This will ensure that taxpayers engaging in aggressive tax planning are no longer able to shift the burden of taxation onto more compliant taxpayers through other (distortive) taxes having to be higher than otherwise, and at the same time will help to provide much needed certainty to taxpayers.

ANNEX

COMPETITIVE TAX SYSTEMS: THE ADMINISTRATIVE DIMENSION

Providing a business friendly tax administration

Business decisions are not only influenced by tax policy parameters (e.g. tax bases and rates) but also by the way in which a tax system is administered. Key questions for tax authorities thus include:

- does the tax administration have a good understanding of business models?
- does it provide a good “service” to business?
- does it provide certainty and predictability in the application of the rules?
- are the rules applied in a consistent and coherent manner?
- what is the cost to business of complying with the letter and spirit of the law; is there a level playing field in terms of tax compliance?
- how far is business engaged in the formulation and application of new tax policy initiatives.

All of these factors can influence MNE’s decisions. Governments will, of course, have to balance these factors against the need to protect the revenue base. There also needs to be an internationally accepted set of rules about what is fair/unfair practice in terms of administrative competition.

The OECD, by means of its Committee on Fiscal Affairs and the Forum on Tax Administration, has for many years helped governments to find the right balance between service and enforcement recognising that good service plus good enforcement is the most effective way to achieving good voluntary compliance.

In 2007, the FTA developed the concept of an “Enhanced Relationship” between taxpayers, their advisors and revenue authorities. The approach was based upon the assumption that the relationship between these three parties should be based upon the following attributes:

1. Understanding based on commercial awareness
2. Impartiality
3. Proportionality
4. Openness
5. Responsiveness

At the same time the OECD has worked in parallel with the EU to develop a set of guidelines on what is fair and unfair tax competition. From the perspective of the tax administration, the key criteria were that the rules should be transparent and non-discriminatory. Thus, for example, any tax rulings offered to taxpayers should be made public.

The remainder of this annex provides more details on these initiatives.

The OECD's role in getting the right balance between service to taxpayers and tax enforcement

Since its creation in 2002, much of the work of the OECD's Forum in Tax Administration¹ has explored aspects of this administrative dimension, in the process encouraging national revenue bodies in a variety of ways to engage more actively and co-operatively with external stakeholders to address aspects of tax compliance, as well as to achieve high standards of taxpayer service. This note draws out the key areas and related themes of the work undertaken.

Enhancing the relationship between revenue bodies, large taxpayers and tax intermediaries

In September 2006, the Forum's Seoul Declaration set out the collective concerns of Forum Commissioners about the role of international tax advisers, financial and other institutions in relation to non-compliance and the promotion of unacceptable tax minimisation arrangements. To address these concerns, the Forum launched a number of initiatives, including a study to examine the role of tax intermediaries (e.g. law and accounting firms, other tax advisors and financial institutions) in relation to non-compliance and the promotion of unacceptable tax minimization arrangements. A report — *Study into the Role of Tax Intermediaries*² — was released in January 2008.

The study's key finding was that revenue bodies could achieve a more effective and efficient relationship in their dealings with taxpayers and tax intermediaries if their actions were based upon the following attributes: 1) Understanding based on commercial awareness; 2) Impartiality; 3) Proportionality; 4) Openness; and 5) Responsiveness. These attributes are fundamental for any revenue body and should underpin all their dealings with taxpayers. If revenue bodies demonstrate these five attributes and have effective risk-management processes in place, large corporate taxpayers are more likely to engage in a relationship based on co-operation and trust. This was described in the report as an '*enhanced relationship*'.

The study report emphasised that an '*enhanced relationship*' can offer benefits for revenue bodies as well as taxpayers. It noted that taxpayers who behave transparently can expect greater certainty and an earlier resolution of tax issues with less extensive audits and lower compliance costs. An *enhanced relationship* between revenue bodies and tax intermediaries (as well as taxpayers) would also yield significant benefits.

Building transparent compliance with banks

In the light of the findings and recommendations of the '*Study into the Role of Tax Intermediaries*', the Forum launched two further studies, one concerning the tax compliance risks presented by banks and the second with a similar focus in respect of 'High Net Worth Individuals'.

The Forum's 2009 report '*Building Transparent Compliance with Banks*'³ set out the conclusions of the study that examined the role of banks in the provision of aggressive tax planning arrangements. It examined the nature of banking, the complex structured financing transactions (CSFTs) developed by banks and how they were then being used by both banks and their clients. The report also examined the internal governance processes used by banks to manage tax risk and the prevention, detection and response strategies applied by different revenue bodies in responding to the challenges that banks pose. Its recommendations for revenue bodies included the following:

- Develop initiatives with banks to enable revenue body staff to improve their understanding of banking operations, particularly governance structures and product development processes concerning CSFTs.
- Work with banks as part of an enhanced relationship through guidance, rulings and real-time discussion of issues.
- Encourage banks to be more transparent so that tax authorities can better understand the commercial context and complex details of CSFTs; and
- Ensure they have necessary strategies in place to prevent, detect and respond to aggressive tax planning.

As a result of follow up work, the Forum in late 2010 published the findings of a study which proposed a ‘*Framework for a Voluntary Code of Conduct*’⁴ to guide relationships between banks and revenue bodies in countries that choose to adopt the framework.

Engaging with high net worth individuals (HNWI) on tax compliance

High Net Worth Individuals (HNWIs) pose significant challenges to revenue bodies due to the complexity of their affairs, their potential contribution to tax revenues, the opportunity for aggressive tax planning, and the impact of their compliance behaviour on the integrity of the tax system. Conscious of such challenges, the Forum in 2008 launched a study to examine in detail this taxpayer segment, describing their usage of aggressive tax planning schemes and ideas for enhancing revenue bodies’ prevention, detection and response strategies to respond to these challenges, based on leading revenue body experience. It also addressed aspects of voluntary disclosure initiatives for past non-compliance that might be particularly pertinent in the aftermath of the global financial crisis.

The Forum publication — *Engaging with High Net Worth Individuals on Tax Compliance*⁵ — published in June 2009 outlined a number of innovative approaches to enable governments to better manage the risks involved with marketed tax schemes and tailor-made arrangements. These included encouraging revenue bodies to develop a stronger commercial awareness of the broader concerns of HNWIs (including privacy and wealth preservation) and establishing a framework for dialogue between senior revenue officials, HNWIs and their advisers.

Promoting strong corporate governance in the area of tax

The Forum is committed to engaging with business and with regulators and other agencies responsible worldwide for the development of corporate governance codes and guidelines, to work towards ensuring that the oversight of tax risk by corporate boards is recognised as a principle of good corporate governance. Experience has shown that corporate boards of directors need to be aware of the reputational and financial risks associated with tax non-compliance and aggressive tax planning, and establish policies and controls for assessing this risk. Building on the experience of a paper presented to its 2009 Paris meeting — *Corporate Governance and Tax Risk Management*⁶ — which outlined the experience of three countries in linking tax to governance, the Forum has set up a project to further develop this work.

To date, much of the work undertaken has proceeded with the constructive engagement of the private sector, including businesses from the banking and technology sectors, as well as other industries. The Forum seeks to enhance, whenever possible, the value of its work products by considering private sector perspectives.

Co-ordinated action in managing international tax risks through joint audits

Globalisation is having an enormous impact on the volume of cross-border trade and related business transactions, presenting significant tax-related challenges for both businesses and revenue bodies.

The Forum has recognised that putting greater emphasis on joint audits can be an important means of increasing international coordination. Audits of internationally operating businesses and globally active high net worth individuals have traditionally been carried on separately or simultaneously which can lead to an increased burden on businesses, individuals and governments. Joint audits are seen as one way of reducing this burden. In the future, taxpayers will encounter joint audits between FTA participating countries. Joint audits go beyond simultaneous audits. A joint audit is a process where two or more countries join together to carry out a single audit of a taxpayer, with all countries receiving the same information and presentations from the taxpayer. If fully realised, joint audits have the potential to both boost international tax compliance and reduce costs for taxpayers (potentially, including some double taxation) and revenue bodies alike.

To support this initiative, the Forum in September 2010 published a report and a practical Guide⁷ intended to inform tax auditors and their strategy teams. The Guide highlights best practice for joint audit procedures and the roles of each participant involved in joint audits accelerating the audit process and providing certainty sooner. By conducting a fully-coordinated audit between participating countries, the Forum aims to enhance compliance with tax rules, as well as to reduce taxpayers' burden of multiple countries conducting separate audits.

Improving taxpayer services

The Forum is committed to ensuring that members' cooperation also extends to delivering high quality taxpayer services and it has reiterated its wish to see continuous improvement of these services in all its member countries.

The Forum has recently published a review⁸ of cutting edge developments in the electronic delivery of taxpayer services across its constituent revenue bodies and is confident that this will allow them and others to plan future service delivery strategies informed by the newest technologies.

The Forum also continues to be conscious of the administrative burden imposed on taxpayers and intermediaries in complying with tax regulations. In this context, it has in both 2008 and 2010 made available the findings of survey work describing countries' initiatives (of both a policy and administrative nature) to reduce the administrative burden imposed by tax regulations, particularly on the business community.⁹

Finally, the Forum has commissioned a project to identify best practice in making tax repayments and tax credits available to taxpayers in ways which can balance speed and integrity. The timely refunding of overpaid taxes — in particular, large amounts of excess VAT credits that typically arise in countries with a high incidence of exports — is a matter of considerable importance to the cash flow of businesses. This project will be completed in mid-2011. The Forum is confident that the findings will assist revenue bodies to strike the appropriate balance between the needs of taxpayers to access repayments speedily and the need to prevent revenue loss resulting from fraudulent claims.

1. Operating within the context of a global economy, rapid technological change and fiscal challenges for government, the Forum on Tax Administration forum aims to improve taxpayer services and tax compliance by helping revenue bodies increase the efficiency, effectiveness and fairness of tax administration and reduce

the costs of compliance. The Forum brings together tax commissioners and other senior officials from over 40 countries to identify, discuss and influence relevant global trends and develop new ideas to enhance tax administration around the world.

2. See '*Study into the Role of Tax Intermediaries*' at www.oecd.org/dataoecd/28/34/39882938.pdf.
3. See '*Building Transparent Tax Compliance by Banks*' at www.oecd.org/ctp/ta/banks.
4. See '*Framework for a Voluntary Code of Conduct for Revenue Bodies and Banks*' at www.oecd.org/dataoecd/10/9/45989171.pdf.
5. See '*Engaging with High Net Individuals on Tax Compliance*' at www.oecd.org/ctp/ta/hnwi.
6. See '*Corporate governance and tax risk management*' at www.oecd.org/dataoecd/37/19/43239887.pdf.
7. See '*Joint Audit Report*' at www.oecd.org/dataoecd/10/13/45988932.pdf and Joint Audit Participants Guide at www.oecd.org/dataoecd/10/11/45988962.pdf.
8. See '*Survey of Trends and Developments in the Use of Electronic Services for Taxpayer Service Delivery*' at <http://www.oecd.org/dataoecd/20/49/45035933.pdf>.
9. See '*Programs to Reduce the Administrative Burden Resulting from Tax Regulations in Selected Countries*' at www.oecd.org/dataoecd/39/6/39947998.pdf and '*Programmes to Reduce the Administrative Burden of Tax Regulations - Follow up report*' at www.oecd.org/dataoecd/58/27/44972185.pdf.

BIBLIOGRAPHY

OECD 2010a, *Tax Policy Reform and Economic Growth*, OECD Tax Policy Study No20

OECD 2010b, *Tax Policy reform and Fiscal Consolidation* Tax policy Brief, December 2010

World Economic Forum, *Global Competitiveness Report, 2010-2011*.

World Bank, *Doing Business 2011*

OECD TAXATION WORKING PAPERS

- No. 1 *Tax reform trends in OECD countries*
Bert Brys, Stephen Matthews and Jeffrey Owens
- No. 2 *What is a competitive tax system?*
Stephen Matthews
- No. 3 *Making fundamental tax reform happen*
Bert Brys
- No. 4 *Trends in top incomes and income inequality and the implications for tax policy*
Stephen Matthews
- No. 5 *The evaluation of the effectiveness of tax expenditures: a novel approach. An application to the regional tax incentives for business investments in Italy*
Antonella Caiumi
- No. 6 *Corporate taxation and SMEs: the Italian experience*
Marco Manzo
- No. 7 *Consumption taxation as an additional burden on labour income*
Fidel Picos-Sánchez
- No. 8 *Non-tax compulsory payments as an additional burden on labour income*
Bert Brys
- No. 9 *Taxation and innovation*
Pamela Palazzi
- No. 10 *Wage income tax reforms and changes in tax burdens: 2000-2009*
Bert Brys
- No. 11 *Shifting from social security contributions to consumption taxes: the impact on low-income earner work incentives*
Alastair Thomas and Fidel Picos-Sánchez

THE OECD TAXATION WORKING PAPERS SERIES ON LINE

The OECD Taxation Working Papers Series may be found at:

- The OECD Centre for Tax Policy and Administration website: www.oecd.org/ctp/workingpapers
- The OECD's online iLibrary: <http://www.oecd-ilibrary.org/>
- The Research Papers in Economics (RePEc) website: www.repec.org

For further information on the OECD Taxation Working Papers Series, please write to: ctp.contact@oecd.org.