

**ICRICT**  
Independent Commission for the Reform  
of International Corporate Taxation



**FOUR WAYS TO TACKLE  
INTERNATIONAL  
TAX COMPETITION**



## ABOUT ICRICT

The Independent Commission for the Reform of International Corporate Taxation aims to promote the international corporate tax reform debate through a wider and more inclusive discussion of international tax rules than is possible through any other existing forum; to consider reforms from a perspective of public interest rather than national advantage; and to seek fair, effective and sustainable tax solutions for development.

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# FOUR WAYS TO TACKLE INTERNATIONAL TAX COMPETITION



## 1 PUT A FLOOR UNDER TAX COMPETITION

Agree on a global minimum effective tax rate and work towards a common definition of the tax base.



## 2 ELIMINATE ALL TAX BREAKS ON PROFITS

Grant tax breaks sparingly and only on local costs to support new productive investment.



## 3 ESTABLISH A LEVEL PLAYING FIELD

End special tax treatment for foreign and/or large companies, and publish existing agreements.



## 4 ENSURE PARTICIPATION

Enable citizen engagement in tax debates and provide civil society access, information and training to productively engage in those debates.



## 1. PUT A FLOOR UNDER TAX COMPETITION

**Agree on a global minimum effective tax rate and work towards a common definition of the tax base.**

The most effective way to put a floor under global tax competition would be to set a minimum effective rate of corporate income tax measured by the total income taxes paid by a corporation over its total profits. Setting a minimum *effective* rate is key because this measurement includes tax breaks to the base (that is, the income on which taxes are charged), and effective rates can often be much lower, and in many cases half, of the statutory rate.<sup>1</sup> In fact, the rules used to calculate

the base are often where most of the tax exemptions (and thus tax avoidance) lie.

The question of what level to set the minimum effective rate is likely to be intensely debated: statutory rates of corporate income tax worldwide appear to be converging around 25 percent but various countries have adopted much lower statutory rates and even more generous cuts to the tax base, and may be reluctant to give them up.<sup>2</sup>

Mobility of capital and acute competition between countries to attract it has resulted in successive reduction in the effective tax rates over time, besides diverting investments to low tax jurisdictions.

For this reason, a global agreement on a minimum effective tax rate would most likely require the existence of a global tax body which allows equal participation for all countries, including the poorest. Only this body could provide the inclusive participation and global legitimacy that this kind of agreement would require. No such body exists at the moment: the Organization for Economic Cooperation and Development (OECD) cannot play

this role because its membership is dominated by rich countries. As we recommended in our Declaration of 2015, Member States should upgrade the UN Committee of Experts on International Cooperation in Tax Matters to an intergovernmental Commission and provide it with adequate resources. In the short term, however, countries should pursue minimum effective tax rates within regional groupings en route towards global convergence. Alternatively, or in addition, if major countries like the US or those within the EU set a global minimum tax rate *for any firm operating (producing or selling) within them*, that would de facto introduce a global minimum tax.<sup>3</sup>



## 2. ELIMINATE ALL TAX BREAKS ON PROFITS

**Grant tax breaks sparingly and only on local costs to support new productive investment.**

In addition to reducing statutory tax rates, countries wage tax competition by awarding tax breaks for particular types of companies or activities. The most harmful tax breaks that should be targeted for elimination are those which apply to corporate profits. These include:

- Special Purpose Entity regimes that allow profits to be routed through holding companies, which are subject to low or no taxation and often provide secrecy or reporting exemptions. Such regimes are an open invitation to multinationals to shift profits into them from elsewhere.
- Tax breaks on the profits from intellectual property, such as the so-called “patent boxes” that have spread across Europe. Although presented as a spur to innovation, such tax breaks are in reality tools of tax competition. If governments seek to encourage corporate research and development (R&D), there are less harmful ways of doing so, such as providing more public funds for research or more tax relief for genuine R&D costs, but in the latter case only as deductions on expenses incurred in the jurisdiction where research takes place.
- Tax holidays, often associated with Special Economic Zones in developing countries. These tax breaks can last as long as ten to fifteen years and create an incentive for companies to shift profits from elsewhere into the subsidiary that benefits from the tax holiday. Once the tax holiday expires, a company may simply re-form or relocate to another country.
- Agreements with individual companies, such as stability clauses in contracts that prevent new laws from applying to investors or advanced tax rulings that sanction complex structures which enable profit-shifting, can result in very significant revenue losses.

Tax breaks on profits are often very expensive in revenue terms and they reward companies for booking profits in particular places at particular times, which is not necessarily the same thing at

“Tax breaks on profits are hard to administer, easy to abuse and can end up rewarding investments which were going to be sufficiently profitable anyway...”



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all as creating lasting investment and jobs. Tax breaks on profits are hard to administer, easy to abuse and can end up rewarding investments which were going to be sufficiently profitable anyway: they are also used extensively as tools of international tax competition. For these reasons, they should be eliminated.

There may be certain circumstances in which tax incentives for corporations are justifiable as a

policy tool, for example in cases of market failure or to achieve social or environmental objectives. However, there will always be a risk of abuse or lobbying by politically-connected sectors for special treatment, or simply that a tax incentive does not justify its cost but remains in place due to inertia and lack of scrutiny. For these reasons, tax incentives need to be applied sparingly and used only to relieve companies' new investment costs, not to boost their after-tax profits.



### 3. ESTABLISH A LEVEL PLAYING FIELD

**End special tax treatment for foreign and/or large companies, and publish existing agreements.**

Tax breaks should be generally avoided, but if absolutely imperative, tax breaks offered to companies should be available to non-residents and residents equally in order to avoid unfair competitive advantages for foreign multinational firms over domestic enterprises, many of which are small and medium in size and lead to the greatest employment growth. Tax advantages that require little or no economic activity (for example, employment, assets, and sales) in the host jurisdiction can act as a barrier for development of domestic innovation and should be regarded as inherently illegitimate and therefore removed as a matter of priority by those countries which offer them. Two types of special tax regimes are of

particular concern in this regard: double taxation agreements and special economic zones.

There are over 3,000 bilateral double taxation agreements that divide taxing rights over approximately \$600 billion of investment flows. Double tax agreements encourage investment flows between treaty partners by reducing or even eliminating withholding taxes on a multinational company's outbound payments of interest, royalties, dividends and various service fees. In addition, these agreements restrict the taxing power or jurisdiction of a host country over the multinational while purely domestic firms do not enjoy these exceptions.

At the same time, non-discrimination clauses in tax agreements bind host countries to giving the same benefits to multinational firms as received by domestic firms. We believe that just as double tax agreements guarantee non-discrimination for multinational firms, they should also require the same for domestic firms, which do not have the ability to transfer taxable profits to foreign subsidiaries through outbound payments. Therefore, withholding taxes and permanent establishment rules in double tax agreements should ensure equitable treatment for domestic and foreign firms.

Secondly, despite the fact that Special Economic Zones may advance economic development objectives by providing one dedicated location for tariff-free logistics and trade, they should not function as mini-tax havens. General Agreement on Tariffs and Trade (GATT) treaty rules prohibit the use of export subsidies, which include direct tax incentives,<sup>4</sup> and thus, any tax incentive must be offered to investments in goods and services alike and to all firms, both foreign and domestic, and regardless of location.



## 4. ENSURE PARTICIPATION

**Enable citizen engagement in tax debates and provide civil society access, information and training to productively engage in those debates.**

The right of citizens to participate in public affairs, including tax debates, is guaranteed under international human rights law.<sup>5</sup> Meaningful participation by citizens depends on transparency and accessibility of information and as a result, governments should ensure openness and participation by encouraging citizen engagement in tax and budget processes, including

Parliamentary debates, for instance, by giving evidence at committee hearings on tax bills.

Specifically, this implies that tax breaks that are granted to relieve investment costs should be subject to public hearing before adoption and when legislated, conditional on the attainment of measurable goals, and should include sunset provisions. Tax expenditures (the cost of tax incentives in place) should be regularly reported to the public in budget expenditure reports which are detailed enough to allow for informed public scrutiny. At a minimum, tax incentives should be reported on an industry sector basis, and ideally on a per-company basis, including the estimated tax expenditures and associated conditions. There should be no secret agreements of the kind offered to Apple by Ireland. Secret conditions can create the risk of corruption and favoritism, and secrecy makes it virtually impossible for civil society to ensure whether the government is in fact complying with the law.

Moreover, we strongly believe that in order to adequately protect the public interest and



preserve the right of citizen participation, the role of civil society should be formalized in national tax and budget processes. This means that civil society should be included in debates and discussions at the highest level. It also means supporting citizen bodies with training so that they can participate at the required technical level and conduct independent research to support their position. Initiatives like the Tax Justice Academy<sup>6</sup> run by Tax Justice Network - Africa are a step forward in citizen engagement on taxation, and should receive wider government support. Even at the local level, citizens can hold their government accountable to avoid procurement from companies which engage in tax dodging.<sup>7</sup>

At the international level, civil society should also play an integral role in augmenting tax

cooperation between countries to set international tax norms and standards, which often have significant effects on the ability of governments to provide the maximum available resources toward the enjoyment of economic, social and cultural rights of their citizens.<sup>8</sup> Civil society organizations have been originators of case studies and tools, such as the Financial Secrecy Index,<sup>9</sup> that illustrate and measure the effects of individual country tax and transparency policies on the ability of other countries to raise much-needed revenues to reduce poverty and inequality within their borders. Thus, the role of citizens in tax processes is vital and should be preserved and strengthened to incorporate the public interest at both the local and global levels.

## RATIONALE: WHY WE NEED MORE EFFECTIVE TAXATION OF CORPORATE PROFITS

### 1. TAXING CORPORATE PROFITS GOOD FOR THE ECONOMY: Corporate income tax is an important source of public revenues, which contribute to investment, employment and long-term sustainable growth.

Most countries levy an income tax on companies just as they do individuals. States give companies the ability to incorporate, which shields the individual owners from legal liability and provides property protections backed by the power of the State. This privileged status paves the pathway for the free flow of commerce and stimulates innovation, and ultimately maximizes productivity of the firms.

The corporate income tax (CIT) also helps to fund public expenditures, such as physical and legal infrastructure, as well as other public goods like education and healthcare that in turn, increase

social stability and the vitality of human capital—all drivers of long-term sustainable growth.

Some economists argue that CIT might have a negative effect on savings and/or investment and that the tax rate should therefore be zero. The argument is that in a large or closed economy, CIT would drain away corporate funds for investment and shareholders receiving reduced dividends might save less, so that banks would have fewer funds for investment. In a small or open economy, the argument runs, higher rates of CIT could induce domestic investors to seek higher returns abroad or deter inflows of capital, thus reducing investment and growth.<sup>10</sup>

This negative view of CIT is not borne out, however, by empirical studies recently surveyed by the International Monetary Fund (IMF). These studies are ambiguous on the size and even the direction of the effect of increased CIT on growth.

*‘‘The corporate income tax also funds public expenditures, such as physical and legal infrastructure, as well as other public goods like education and healthcare that in turn, increase social stability and the vitality of human capital—all drivers of long-term sustainable growth. ’’*

The IMF’s own econometric study does find modest negative effects, but these are small and not very statistically significant.<sup>11</sup> Specifically, in relation to foreign investment, the IMF finds evidence that CIT rates affect financial flows into developing countries, but these flows do not in fact contribute to either real investment or economic growth.<sup>12</sup>

It is also important to note that corporate investment decisions are complex, and rely on the fact that external finance, for example, through banks, is always an alternative to retaining profits so that tax levels will influence funding structures (the use of debt in particular) rather than the level of investment.<sup>13</sup> Economic theory and evidence suggest that the adverse effects, if they exist, are much less than is commonly alleged, especially by politicians and corporations. Almost all countries provide an exemption for interest payments (the abuse of this exemption was one of the subjects on which the OECD Base Erosion and Profit-Shifting (BEPS) project focused.) Since at the margin, a very large fraction (indeed most) investment is financed by debt, the reduction in return is commensurate with the reduction in cost: there is, therefore, no adverse effect. Indeed, since most countries provide depreciation allowances that are greater than true economic depreciation (that is, depreciation allowances that would correspond to the true decline in market value), higher tax rates can actually be associated with greater investment.<sup>14</sup>

Moreover, modern growth theory suggests that design of CIT to stimulate firms’ investment in worker training or R&D will result in higher productivity growth.<sup>15</sup> The resources mobilized by

CIT have a positive effect on private investment when applied to productive infrastructure (such as transport), human capital formation (skills) and R&D. This is particularly important where the revenue originates from rents generated by natural resources.

Thus, while it may be true that all taxes depress consumption and investment demand and CIT is no exception, compensating government expenditure even within a balanced budget regime will raise demand and stimulate employment and output even more, particularly where there is unemployment. Within this regime, the CIT is an essential element of public fiscal resources and there is no reason to believe that at present rates it significantly constrains investment, growth or employment.

## **2. TAXING CORPORATE PROFITS PROMOTES SOCIAL JUSTICE: Corporate Income Tax plays an important role in reducing inequality by strengthening progressive taxation and by providing funds for public services and social protection programs.**

Across the globe, countries consistently levy a CIT on corporate profits largely because it is easier to collect tax from registered and regulated companies than profits in the hands of individual shareholders, many of whom may reside abroad (or pretend to, by holding their shares through offshore companies or trusts). The CIT also effectively taxes earnings that companies retain, which are hard to tax at the individual level. If there were no CIT, small businesses could escape tax by incorporating and labelling their earnings as



capital income. Thus, the CIT is in effect a ‘withholding tax’ on dividends otherwise payable to shareholders by reducing dividend pay-outs or the capital value of the firms’ retained earnings. As a result, the CIT is a tax on the rich, who are the main owners of corporations, directly as shareholders or indirectly as participants in investment (including pension) funds.

The CIT has an important role in reducing inequality. Household income distribution—one of the most-cited measures of inequality—is not in

capital-labor ratio; so labor productivity falls (this model assumes full employment) and as a result, wages decrease. Small, open economies are particularly sensitive to CIT variability under this view. Therefore, they assert that profits taxation should be replaced by consumption taxation, such as the value added tax (VAT). This notion, however, has little or no empirical basis. A recent comprehensive survey of the empirical literature finds “some evidence that suggests that corporate taxation may lower wages, but the preponderance

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fact determined by the wage/profit split alone, but also by the reduction of the disposable incomes of the richest households through progressive taxation of capital income and the increase in the incomes of the poorest through social expenditures. This social expenditure (universal free health and education, pensions, unemployment pay, etc.), funded in part by CIT, also has an indirect macroeconomic effect by increasing domestic demand and thus, output and employment, also reducing inequality.

Some economists,<sup>16</sup> however, have held that workers (and not corporate owners) bear the greatest burden of the tax, arguing that the CIT “leads to lower investment and thus a lower

of evidence does not suggest any wage effects from corporate taxation ... there is no robust evidence that corporate tax burdens have large depressing effects on wages.”<sup>17</sup>

Moreover, increased reliance on VAT in both developed and developing countries in response to capital mobility has also worsened household income inequality because VAT is generally regressive with the greatest tax burden falling on immobile unskilled labor.<sup>18</sup> Last but not the least, there is growing evidence for the positive effect of reduced inequality directly on growth whether through enhanced social stability (and thus reduced investor risk) or through greater family investment in health and education.<sup>19</sup> As a result, CIT revenues can make a significant contribution



to the reduction of income inequality and to the increase of social stability and sustainable growth in the long run.

### **3. TAXING GLOBAL PROFITS PROMOTES DEVELOPMENT:** Corporate income tax revenue is even more important to developing countries, which receive international investment.

Typically, CIT revenues account for around 8 percent of fiscal revenue in developed countries and 16 percent in developing ones – about 4 percent of global GDP or US\$ 3 trillion a year.<sup>20</sup> The importance of CIT revenue to developing countries has been rising over time: in the 1980s it represented about 12 percent of fiscal revenue. At the same time, statutory CIT rates have fallen since the 1980s, and the effective tax burden on profits is much lower due to widespread tax breaks. The rising revenue share despite this reduction in rates implies that the tax base has in fact been growing despite profit-shifting abroad by large firms. This appears to be due to two factors: on the one hand, the growing share of profits in

national income in response to structural adjustment programs (liberalization, privatization, wage restraint, etc.); and improved tax administration capturing small and medium firms from the ‘informal’ sector within the tax system on the other.<sup>21</sup>

Nevertheless, there are enormous pressures from foreign investors and foreign governments to extend further tax concessions in the form of tax holidays, tax-free zones, investment and tax treaties and acceptance of corporate ownership structures designed to facilitate tax avoidance. Such concessions are often designed to favor foreign over domestic firms, imposing a disadvantage on the latter. The scale of losses from the last factor is large: around USD 100 billion annually according to the OECD.”<sup>22</sup> Tax breaks to attract capital inflows seem to bring few long-term benefits: in a study of developing countries in Latin America and the Caribbean and in Africa, the IMF finds evidence that lower corporate income tax rates and longer tax holidays are effective in attracting foreign investment, but not in boosting gross private fixed capital

formation or growth.<sup>23</sup> Moreover, even when lower rates and generous tax breaks bring more investment to one country, it is not clear this brings more investment to developing countries as a whole. To the contrary, tax breaks seem to simply shift the location of production from one country to another, and as overall revenue for developing countries is reduced, so is development.

Given their greater dependence on CIT revenues and often critical need to fund national development priorities, it is vital for developing countries to be able protect their corporate tax base and levy a reasonable tax rate on large firms whether foreign or domestically owned.

Therefore, global corporate profits need to be taxed in a more effective way. The rate of corporation tax has declined worldwide and the tax base is increasingly undermined by aggressive avoidance schemes, tax giveaways and opaque offshore corporate structures.

Since the 1980s, statutory CIT rates have declined from around 45 percent to around 25 percent in developed countries. In high- and middle-income developing countries the rate has fallen from 40 percent to 25 percent; and in low-income developing countries from 45 percent to 30 percent.<sup>24</sup> There are domestic reasons for this shift, including changing attitudes to the private sector and the decline of organized labor. Moreover, as capital mobility increases worldwide, competition between countries to attract foreign firms (and retain their own) has been a major driver.<sup>25</sup>

In fact, effective CIT rates – that is, the amount of tax corporations actually pay as a proportion of profits<sup>26</sup> are lower than these statutory rates because of the large tax breaks given to firms, either through agreement or domestic tax legislation. The World Bank and the accounting firm PwC estimate that in high-income OECD countries the effective rate is now only 14.9 percent of profits for a medium-sized domestic company, while in developing countries it varies

by region – from 11 percent to 20 percent - with an average of around 15 percent. Worldwide the average CIT burden for this type of company is estimated at only 14 percent of (declared) profits.<sup>27</sup>

Multinational entities (MNEs) pay an even lower effective rate because a large part of their profits are reported in offshore financial centers, giving them an unfair advantage over domestic firms. As a result, the key issue is not so much the statutory CIT rate but rather the CIT base, which is eroded both by excessive tax breaks to firms and the shifting of profits to lower- or zero-tax jurisdictions. Unsurprisingly, MNEs increasingly lobby for more of the former and take advantage of the latter.

A recent survey<sup>28</sup> of econometric work suggests that MNEs as a whole transfer up to 30 percent or more of their income earned from affiliate entities in high-tax jurisdictions to those in lower-tax jurisdictions. The United States, for instance, suffered estimated losses in 2004 and 2008 of \$60 and 90 billion respectively or about 30 percent of CIT revenues.<sup>29</sup> The OECD conservatively estimates that base erosion and profit-shifting causes revenue losses worldwide of between \$100 and 240 billion annually, equivalent to between 4 percent and 10 percent of global revenues from CIT.<sup>30</sup> IMF researchers have offered a higher estimate of approximately \$200 billion in revenue losses or about 1.3 percent of GDP for non-OECD countries and between \$400 and \$500 billion for OECD countries, or in the order of one percent of GDP.<sup>31</sup> If the CIT is to be saved from this downward trend (both in terms of the base and rate), the system of taxing global profits requires radical alteration.

Note that while profit-shifting is sometimes only a matter of socially unproductive spending on more tax lawyers and accountants, tax competition more generally results in the location of production activities in places where it is not efficient from a global perspective. Thus tax competition actually harms global growth, both directly, through depriving especially developing

countries of revenues needed for growth-enhancing public investments, and indirectly, through its distortionary effect on the allocation of public investment.

Without strengthened international tax cooperation, such an alteration will not be possible. Tax cooperation is necessary in a globalized economy, while tax competition leads to global welfare losses. The prevailing narrative of competition for foreign investment between countries underpins a system of uncoordinated and outdated rules, ever-increasing tax breaks, and tax secrecy.

Unbridled competition between countries to attract foreign firms by lowering statutory rates, granting tax breaks, and providing secrecy of ownership creates ‘winners’ and ‘losers’, but overall, it leads to a welfare loss worldwide. Despite arguments that tax competition creates incentives for more efficient government spending, there is no evidence that international tax competition makes governments more efficient nor is there any reason to think that it would, given that other forms of taxation make up a more significant share of government revenues. Instead, this approach undermines the collection of revenues that help to provide basic public goods and build strong, sustainable economies.

The IMF identifies two separate ‘spillovers’ from this de facto regime built up of different and competitive national systems and a patchwork of double taxation treaties, which permits increased MNE tax avoidance. Tax base erosion by profit-shifting incentives (‘base spillover’) means that a 1 percentage-point increase in a country’s CIT rate will reduce its CIT tax base by about 0.6 percent of GDP. Tax policy response to other countries (‘strategic spillover’) means that a one point CIT rate reduction in most countries induces a 0.5 point rate cut, with a slightly larger response to rates in ‘haven’ countries. Also, larger countries’ tax policies have a stronger effect on other countries.<sup>32</sup>

The welfare losses<sup>33</sup> arise from the externalities generated by one country’s tax rate-setting on the welfare of other countries. A lower tax rate in other countries moves capital out and reduces tax revenue and public spending; whether the best response to this is to raise or lower the tax rate depends on the marginal value of public spending. In terms of the game theory underlying the literature, the Nash equilibrium is Pareto inefficient: all countries would benefit from a uniform increase in tax rates. This is the central result in the argument against unconstrained international tax competition. This conclusion is strongly reinforced if (a) CIT resources are used to



enhance productivity; and (b) income distribution has an effect on growth.

Indeed, as the world has become increasingly concerned about inequality, the effects of tax competition on inequality should be given more attention. To the extent that countries attempt to recover tax revenues lost as a result of tax competition, they will have to turn to taxing less mobile factors: unskilled labor and small- and medium-sized domestic businesses. As a result, CIT competition inevitably results in greater inequality.

The tax competition ‘poster child’ is the classic tax haven, which may offer tax secrecy, low or zero tax rates, a wide treaty network, possibly a special economic zone granting generous tax exemptions on direct taxes, and various tax breaks, often for companies owned by non-residents or not engaged in the domestic economy, while maximizing their own fiscal income as free riders. Such facilities often provide secrecy to shield owners, by impeding financial or other regulators of other countries from ascertaining the balance sheet position or other aspects of the activities of multinational corporations.<sup>34</sup> The Panama Papers and the Bahamas Leaks have exposed the global reach of such networks enabled by a chain of intermediaries such as banks, law and accounting firms. Such secrecy also combined with special

tax breaks often attracts and facilitates money laundering, and thus, supports a variety of illicit activities, again as illustrated by the Panama Papers.<sup>35</sup>

Additionally, as revealed in the Luxembourg Leaks scandal, revenue authorities may directly provide tax rulings to facilitate preferential tax arrangements for various company structures under a cloak of secrecy. Ironically, this secrecy must be combined with strong property rights to protect both the hidden assets and the identity of the owner – so that such jurisdictions are invariably within or effectively underwritten by major financial centers. Tax havens can only exist under the protection of a developed country, which can guarantee the rule of law. Without confidence that some regulatory authority will protect the asset owner’s property and privacy from the hosting intermediary and other countries’ regulators, these shelters would effectively be shut down. As the report *Overcoming the Shadow Economy* argues, these offshore centers provide no socially productive benefits to the global economy and impose enormous harm, and exist only because they are tolerated—indeed, virtually encouraged—by leading developed countries. Special interests within those countries have found it convenient to use these offshore centers for tax and regulatory circumvention.



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The adverse effects of tax competition on the economy and society at both the national and global levels are even worse than just described. Individual income can easily be converted into corporate income, and thus, if the corporate income tax is *de facto* low, high income individuals *de facto* will pay a low rate on their capital income. Thus, overall, the tax system becomes regressive. Regressive tax systems,

rightly, are viewed as unfair. Our tax system requires voluntary compliance, but it will be increasingly difficult to get such voluntary compliance if the tax system is viewed as unfair. Moreover, a regressive tax system leads to a more unequal society; and – as we have noted, more unequal societies perform more poorly, are more divided, and their economies grow more slowly and are subject to more instability.<sup>36</sup>

## TACKLING TAX COMPETITION: THE NEED FOR A HOLISTIC APPROACH

At the July 2015 Third International Conference on Financing for Development in Addis Ababa, Ethiopia, the G77 and China's proposal for a UN intergovernmental tax body to ensure such coordination was effectively quashed.<sup>37</sup> Instead, the G20 working through the OECD, has taken the lead on global tax coordination in standard setting, implementation and evaluation through two subsidiary bodies: the 'Inclusive Framework' for international tax standards and the 'Global Forum' for implementation of transparency and information exchange measures.

All countries have been encouraged to join as members to implement standards set by the OECD and the G20. Countries that fail to adopt and implement the tax transparency standards as well as participate in the appropriate legal instruments by mid 2017 could be subject to economic sanctions by other G20 and OECD countries. Although such coordination efforts are a step forward, there remains a core global governance problem due to the lack of equal, effective and timely participation of developing countries.<sup>38</sup>

As long as the G20 and the OECD are dominated by the rich countries, the outputs will be geared to the interests of those countries. The OECD's

spotty history of blacklisting is well known and illustrates the difficulty of trying to tackle tax competition in the absence of a globally representative body. After the G7 leaders mandated the OECD to address 'harmful tax practices', the OECD created a 'black list' of tax havens in 2000, most of whom were taken off just two years later after agreeing to the OECD standards of information exchange.<sup>39</sup> By 2009, all jurisdictions were taken off the list but, as the Panama Papers demonstrate, many jurisdictions which were initially removed from the list in 2000, namely the jurisdictions and dependencies of the leading countries of the OECD, continued to conduct business as usual.<sup>40</sup>

More recently, during the BEPS process, the Forum on Harmful Tax Practices found that 16 regimes that gave tax breaks on profits from intellectual property ('patent boxes') were either wholly or partially inconsistent with the agreed 'nexus' criteria that the tax breaks from patent boxes are allowed so long as they are commensurate to R&D expenditures by the taxpayer. Some countries have already proposed amendments, notably the United Kingdom, to its patent box regime. However, other countries, such as Switzerland and Ireland, have newly introduced

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patent box regimes, compliant with the nexus criteria.<sup>41</sup>

Many observers have criticized the outcome of BEPS on patent boxes as legitimizing and even intensifying tax competition. Yet the OECD has made clear that the purpose of its work on harmful tax competition has been to create a wall between ‘helpful’ and ‘harmful’ tax competition. The most recent report of the FHTP states that the forum is “not intended to promote the harmonization of income taxes or tax structures generally within or outside the OECD, nor is it about dictating to any country what should be the appropriate level of tax rates” but only to encourage “free and fair tax competition”, a “level playing field” and “expansion of global economic growth.”<sup>42</sup> While we agree that there should be a level playing field, which precludes favoritism toward foreign firms, along with inclusive global economic growth, in practice “free and fair tax competition” amounts to no more than a race to the bottom.

The Member States of the European Union attempted a similar effort to identify and curtail harmful tax practices via their Code of Conduct Group on Business Taxation, set up in 1998.<sup>43</sup> In practice, the designation of tax practices as harmful came down to negotiation among European governments, including those which had adopted these practices. The process has been a failure: it did not prevent any of the egregious abuses which have been revealed in recent years by the Luxembourg Leaks scandal, investigations by the media and civil society and the illegal state aid inquiries of the European Commission. Yet the European Commission continues to promote “fair tax competition” as a principle of good tax governance; the only thing seemingly precluded is “special deals” which are treated as State Aid, and it is for this that Ireland was chastised.

As a Commission, we believe the historical record shows that it is fruitless to continue existing efforts, which rely on the notion that



*“Countries do – and should – compete internationally but this must be in terms of the skills of their labor force, the quality of their infrastructure, their capacity for innovation and above all the inclusiveness of their societies.”*

“free” and/or “fair” tax competition can be separated from the harmful variety. In reality, all international tax competition has the potential to undercut countries’ fiscal bases. Solutions cannot be negotiated on a case-by-case basis between governments, or even within exclusive groups of countries which set rules for others to implement. Inevitably such rules are geared toward protecting favored tax breaks (and of course, favored firms) even when these demonstrably undercut the tax revenues of other countries. Moreover, piecemeal attempts to curb particular “harmful” practices simply invite countries to invent new kinds of tax incentives, which achieve the same tax-reducing effect but fall outside the current criteria of harmfulness.

A consistent and integrated approach is required, one which recognizes the vital contribution made by the CIT to fiscal resources and social equity, and

which allows some variation between national tax systems while ensuring common minimum standards to protect the public interest of all. In order to secure long-term sustainable growth and ensure the fulfilment of governments’ human rights obligations to its citizens, while advancing the development of poor countries, we must recognize the high cost of tax competition. Instead, we must set our sights on strengthened international cooperation underpinned by equal participation by all countries to deliver effective global tax reform. Countries do – and should – compete internationally but this must be in terms of the skills of their labor force, the quality of their infrastructure, their capacity for innovation and above all the inclusiveness of their societies.



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- <sup>2</sup> The United Kingdom has announced that it will cut its main Corporation Tax rate to 17 percent by 2020. See H.M. Revenue and Customs, Guidance on Rates and Allowances: Corporation Tax, 1 April 2016
- <sup>3</sup> To prevent vertical disintegration, one would have to devise certain control and ownership rules
- <sup>4</sup> GATT Agreement on Subsidies and Countervailing Measures, Annex I (e)
- <sup>5</sup> *International Covenant on Civil and Political Rights*, Art. 25 (1966). See also *Maastrich Principles on Extraterritorial Obligations of States in the Area of Economic, Social and Cultural Rights*, Principle 7 provides: "Everyone has the right to informed participation in decisions which affect their human rights. States should consult with relevant national mechanisms, including parliaments, and civil society, in the design and implementation of policies and measures relevant to their obligations in relation to economic, social and cultural rights"
- <sup>6</sup> <http://www.taxjusticeacademy.net>
- <sup>7</sup> Christian Aid, Local Governments persuaded to step up efforts to challenge tax dodging, <https://medium.com/christian-aid-campaigns/local-government-persuaded-to-step-up-efforts-to-challenge-tax-dodging-84166a359462#.4dyx05j5q>
- <sup>8</sup> Report of the Special Rapporteur on extreme poverty and human rights, Magdalena Sepúlveda Carmona, 22 May 2014, A/HRC/26/28
- <sup>9</sup> <http://www.financialsecrecyindex.com>
- <sup>10</sup> Mirrlees, J. A., (1976) 'Optimal tax theory: a synthesis' *Journal of Public Economics* vol. 6(4), pages 327-358. Bovenberg, A.L. (1994) 'Capital taxation in the world economy' pp. 116-150 in F. van der Ploeg *Handbook of International Macroeconomics* Oxford: Blackwell
- <sup>11</sup> 'Fiscal Policy and Long Term Growth' IMF Policy Paper, April 2015
- <sup>12</sup> Klemm, A and S van Parys (2009) Empirical Evidence on the Effects of Tax Incentives IMF WP/09/136
- <sup>13</sup> Stiglitz, J (1976) The corporation tax *Journal Of Public Economics* 5 303-311
- <sup>14</sup> Stiglitz, J (1973) "Taxation, Corporate Financial Policy and the Cost of Capital," *Journal of Public Economics*, 2, February 1973, pp. 1-34. (Subsequently published in *Modern Public Finance*, 1, International Library of Critical Writings in Economics, No. 15., A. Atkinson (ed.), Elgar, 1991, pp. 96-129
- <sup>15</sup> Aghion, P. and P. Howitt (1998) *Endogenous Growth Theory* Boston: MIT Press
- <sup>16</sup> Harberger, A.C The Incidence of the Corporation Income Tax. *The Journal of Political Economy*, Vol. 70, No. 3 (Jun., 1962), pp. 215-240
- <sup>17</sup> Clausing, K. A. 2012. In Search of Corporate Tax Incidence. *Tax Law Review*. 65:3. 433-472
- <sup>18</sup> Tax Policy Reform and Economic Growth *Tax Policy Studies* No 20 Paris: Organisation for Economic Cooperation and Development (2010) p. 20
- <sup>19</sup> Ostry, J.D. and others Redistribution, Inequality and Growth IMF Staff Discussion Note SDN/14/02 2014, available at <https://www.imf.org/external/pubs/ft/sdn/2014/sdn1402.pdf>

- <sup>20</sup> WB/PWC Doing Business. Sub-total and world weighted by GDP (WEO)
- <sup>21</sup> In consequence the IMF argues that: “base erosion, profit shifting and international tax competition really matter for developing countries ... at least as much as for the advanced economies.” WP/15/118 IMF (2015) *Base Erosion, Profit Shifting and Developing Countries*, Ernesto Crivelli, Ruud De Mooij and Michael Keen
- <sup>22</sup> OECD 2010, p. 6 *Promoting Transparency and Exchange of Information for Tax Purposes*
- <sup>23</sup> IMF WP/09/136 (op. cit)
- <sup>24</sup> IMF *Fiscal Monitor* 2014
- <sup>25</sup> Leibrecht, M and C Hochgatterer, 2012, “Tax Competition as a Cause of Falling Corporate Income Tax Rates: A Survey of Empirical Literature,” *Journal of Economic Surveys*, Vol. 26, 616–48
- <sup>26</sup> World Bank (2016) Doing Business <http://www.doingbusiness.org/data/exploretopics/paying-taxes>
- <sup>27</sup> See supra note 20
- <sup>28</sup> Reidel, N (2014) Quantifying International Tax Avoidance: A Review of the Academic Literature European Tax Policy Forum
- <sup>29</sup> Clausing, K.A. (2011), The Revenue Effects of Multinational Firm Income Shifting, *Tax Notes*, March 2011
- <sup>30</sup> <http://www.oecd.org/ctp/policy-brief-beps-2015.pdf>
- <sup>31</sup> IMF (2015) Base Erosion, Profit Shifting and Developing Countries. Page 21, Figure 3
- <sup>32</sup> IMF (2014) Spillovers in international corporate taxation
- <sup>33</sup> Zodrow, G.R. (2010), “Capital mobility and capital tax competition”, *National Tax Journal* 63(4):865–902. Wilson, J.D. (1999), “Theories of tax competition”, *National Tax Journal* 52(2):269–304
- <sup>34</sup> Slemrod, J. and Wilson, J.D., ‘Tax competition with parasitic tax havens’, *Journal of Public Economics*, vol. 93, nos. 11-12 (December 2009), pp. 1261-1270
- <sup>35</sup> Joseph Stiglitz is also a Commissioner of ICRICT. See Stiglitz J. and Pieth M. (2016) *Overcoming the Shadow Economy*
- <sup>36</sup> IMF, Fiscal Policy and Income Inequality, Jan. 22, 2014
- <sup>37</sup> <http://mnetax.com/proposal-upgrade-un-expert-tax-committee-fails-9924>. A similar proposal also failed in 2004, when the UN Secretariat made a similar recommendation to transform the old “ad hoc” group of experts into an intergovernmental body; in any case, it was then upgraded to a regular committee
- <sup>38</sup> The governance structure has to adequately represent developing countries. Voting weighted by population would clearly give preponderance to developing countries; but even voting weighted by GDP (which could be seen as logical on economic matters) would balance the interest of developed and developing countries as their contribution to global output is similar
- <sup>39</sup> OECD (2000) Towards Global Tax Co-operation: Report to the 2000 Ministerial Council Meeting and Recommendations by the Committee on Fiscal Affairs, *Progress in Identifying and Eliminating Harmful Tax Practices*, at 16-17
- <sup>40</sup> For full data, see <https://panamapapers.icij.org/graphs/>
- <sup>41</sup> PwC Tax Insights, Switzerland passes final corporate tax reform package to enhance global competitiveness, 22 June 2016, available at <https://www.pwc.com/us/en/tax-services/publications/insights/assets/pwc-switzerland-passes-final-corporate-tax-reform-package.pdf>; Mason, Hayes and Curran, Tax Update: Irish 6.25% Knowledge Development Box, available at <http://www.mhc.ie/latest/insights/irish-6.25-knowledge-development-box>
- <sup>42</sup> OECD (2015) Countering Harmful Tax Practices More Effectively, Taking into Account Transparency and Substance, Action 5 - 2015 Final Report, at 11, OECD/G20 Base Erosion and Profit Shifting Project
- <sup>43</sup> <http://www.consilium.europa.eu/en/council-eu/preparatory-bodies/code-conduct-group/>

# ICRICT COMMISSIONERS



**Mr. Edmund Fitzgerald**, from the United Kingdom, is Professor of International Development Finance, Oxford University and Fellow of St Antony's College, Oxford.



**Ms. Ifueko Omoigui Okauru** served as Commissioner General of Nigeria's Federal Inland Revenue Service and was a Member of the Committee of Experts on International Cooperation in Tax Matters. She is currently Managing Partner of Compliance Professionals Plc.



**Ms. Eva Joly** was born in Norway and is a Member of the European Parliament where she serves as Vice-Chair of the Special Committee on Tax rulings.



**Mr. Léonce Ndikumana** was born in Burundi and is a Professor of Economics at the University of Massachusetts.



**Rev. Suzanne Matale** is the Head of the Zambian Council of Churches.



**Mr. M. Govinda Rao** is the former Member of the Finance Commission, Member of the Economic Advisory Council to the Prime Minister of India, and Director of the National Institute of Public Finance and Policy in India.



**Mr. Manuel Montes**, born in the Philippines, serves as Senior Adviser for Financing and Development at The South Centre.



**Ms. Magdalena Sepúlveda Carmona** from Chile, is a Human Rights Lawyer and recently served as the United Nations Special Rapporteur on Extreme Poverty and Human Rights.



**Mr. José Antonio Ocampo (Chairperson)** is Colombian and former United Nations Under-Secretary General and former Minister of Finance of Colombia. He is currently a Professor at Columbia University.



**Mr. Joseph Stiglitz** is from the United States and University Professor at Columbia University. In 2001, he was awarded the Nobel Memorial Prize in Economics.



# ICRICT

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of International Corporate Taxation

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