THE TRANSFORMATION OF GLOBAL GOVERNANCE PROJECT

18-19 FEBRUARY 2019 SEMINAR

TAXATION GOVERNANCE IN GLOBAL MARKETS:

CHALLENGES, RISKS AND OPPORTUNITIES

Seminar takeaways

▪ Keynote

Global taxation problems had achieved a great amount of salience in recent years, with the leaks of confidential documents swaying public opinion, bringing the issue to third place in citizens' concerns in a recent Eurobarometer poll. The speaker was pleased to recall that thanks to the work of the OECD under G20 instruction, 14 international proposals against tax evasion as well as 8 against tax fraud have been adopted by member states since 2014: more than in the 20 preceding years.

The speaker emphasised his three guiding principles for working towards coordination in international taxation: transparency, cooperation, and modernisation. Much progress has already been made on transparency: banking secrecy has for the most part been abolished with the extension and automatisation of exchange of information procedures, making it more difficult to hide revenues and assets. Efforts are under way to make public member states' tax planning schemes public by 2020, and there is robust dialogue with member states who use their taxation rates as a comparative advantage.

On international cooperation, the speaker emphasised that only working within the European perimeter was insufficient, crediting interactions between the EU, the OECD and the G20 for a good implementation of rules and an effective name-and-shame process against non-cooperative jurisdictions. To one participant questioning the wisdom of the EU's designs for a digital services tax while the US-led trade war ratchets up, he answered that it was not such an uncooperative move, as different reactions had come back from different parts of the administration: for example, the Trade Department was openly hostile whereas the Treasury was not opposed.

Finally, the speaker recalled the need for modernisation of outdated tax rules leading to tax injustice, highlighting the European Commission's proposals for VAT reform (which could recover 50B€ per year), for a consolidated corporate tax base, or for a digital services tax. He deplored the fact that despite successes in fighting tax fraud and evasion, certain member states have been blocking these bolder proposals due to the unanimity imperative, and voiced his support for unblocking the issue with the passerelle clause and advocated for its clearer governance within the EU, with a Eurozone Minister for Finance with powers over taxation. The speaker concluded by looking forward to action on digital taxation and crafting a unified EU position for the upcoming G20 in Osaka.

Session I – The framework for transparency and exchange of information: achievements and shortcomings

Critical to the social contract is the idea that all must pay their fair share of taxes, which entails governments' abilities to capture mobile tax bases: individuals or multinational corporations (MNCs) who have the resources to avoid this. Before the global financial crisis, it was estimated that a significant proportion of global wealth (some 6% or 9T$) was held in offshore accounts, impacting developing and less-developed countries disproportionately. Information exchange was very limited due to banking secrecy, or conditional upon request since G20 action in 2008. However, tax avoidance and evasion issues rose to international attention with the crisis; unilateral action by the USA had game-changing effects, paving the way for multilateral action by the G20.

The 2010 Foreign Account Tax Compliance Act (FATCA) used the USA's market power to coerce financial institutions to report data concerning US citizens or face penalties. This created problems in jurisdictions where complying meant violating domestic law. Their financial actors lobbying for a solution, kicking off the debate on information exchange led by the OECD. FATCA conventions and concepts were essentially multilateralised by the OECD and were adopted in 2014 as the Common Reporting Standard (CRS), instituting automatic exchange of information. While concerns exist about the information's quality (it does not include assets such as real estate for example), its usability for developing countries, or its potential misuse by authoritarian regimes, it is a powerful step forward in international taxation governance: 108 jurisdictions have agreed to automatic exchange of information (excluding, notably, the USA), 90 have already begun exchanging, and 93B$ has been recovered. However, success was attained only because the interests of the largest sovereigns aligned with other countries against those of tax havens: there was no developed/developing countries divide since the benefits of cooperation were non-rival. Attempts to replicate this strategy for corporate taxation would most likely backfire due to the underlying distributional issues. Politicians have celebrated perhaps prematurely and complacently the progress made, out of step with public opinion for whom it is less effectively visible; the result may be increased demand for radical transparency.

> *"Before, rich people lied and governments did not know; now, rich people lie and governments do not act. Which is better?"*

Discussion among participants focused on the remaining problems in taxation governance, especially corporate taxation, and anticipated the discussion of taxation of the digital economy. One participant recalled the difficulty of supervision and enforcement even when national legislation has been enacted, and highlighted the ongoing work within the OECD's Global Forum as well as its Inclusive Framework on base erosion and profit shifting (BEPS) on outstanding issues such as beneficial ownership, transfer pricing, taxpayer rights, and country-by-country reporting. To the unease over method expressed by one European participant, an American participant responded that American unilateralism had been an effective use of realpolitik that had benefitted both the USA and the world; but later exhorted other countries to put pressure on the USA to join the CRS. Exchanges took place over the necessary degree of confidentiality of the information exchanged: some is necessary to ensure trust in the instrument, but more transparency can be a powerful tool for workers' rights. Several participants underscored the fact that data exchange without capacity-building is ineffective, even for developed countries: one pessimistically remarked that we could be facing a situation where "Before, rich people lied and governments did not know; now, rich people lie and governments do not act."

Some questioned whether the issue of corporate taxation is as intractable as was presented, since it is a (admittedly difficult) distributional conflict, but with the possibility of recovered income and side-payments. One participant asserted that the USA had solved the issue for itself by imposing a minimum tax on MNCs headquartered in its jurisdiction to capture stateless income, whereas the EU had not. The same participant had to concede, however, that such a tax only works for some large jurisdictions; it is residual, creating a floor unlikely to impulse additional cooperation; and it only works as a global solution if there are compliance mechanisms to ensure no defectors. It also leaves the problem of mobility intact, and questions were raised as to whether the level of the tax is sufficient to discourage offshoring. Nevertheless, with revenue thus assured, it is ironically the USA who is willing to shift the principle to taxation from source to destination market base, whereas it is the EU that is reluctant due to the distributional issues, preferring to try to capture revenue from American tech giants and platforms but not have their own big companies or financial institutions taxed elsewhere. To one participant remarking that taxation, for simplicity's sake, had long focused on immobile factors of production, which led governments to imposing those they were accountable to, another participant emitted the idea that

> *"Europeans want to tax Google, but they don't want China to tax Louis Vuitton"*

corporate taxation should be conducted at the individual level for the same reason: this would require more global cooperation, but raise less thorny distributional issues.

▪ Session II – Tax coordination and the digital economy: Alternative ways forward

With varying levels of detail in chapters, earlier iterations of BEPS backfired in strengthening the arm's length principle while deadlocking over transfer pricing, creating perverse incentives for companies to offshore. This led to the USA's unilateral move to minimum taxation. In the meantime, the digital economy is still not being taxed in a satisfactory manner in the opinion of many (if not all) countries as well as large and increasing swathes of public opinions worldwide. While at first glance this unilateral rationale can be invoked for the EU's proposed Digital Services Tax (DST) and similar measures being enacted in European countries while it stalls, some argue it would conflict with existing and developing tax treaties. The crux of the debate how to allocate profit depending on observable factors: much more than BEPS, this raises difficult distributional issues.

Other models to the DST have been put forward to capture the same revenue. There is the UK's proposal based on "user participation", but it does not avoid the problem of ring-fencing (financial separation of a portion of a company's assets or profits without necessarily being operated as a separate entity). The USA's favoured proposal based on "marketing intangibles" poses difficulties regarding the substantiation of linking intangibles with specific markets and the apportionment of market intangibles to other intangibles. Taking a wider look however, the failure in capturing the digital economy is merely an extension of the fact that large enough companies can essentially choose where to make profits and pay tax. Public pressure, especially brought to bear after the LuxLeaks, has been a driver of change, but it is slow, difficult, and there is an appalling lack of data that could contribute to better policy formulation and the emergence of international leadership. In this context unilateral or regional measures (such as the DST) have their use, as they can jumpstart action. Yet the Europeans (France and Germany in particular) do not seem able or willing to push this option.

> *"Companies can choose where they make profits and where they pay taxes"*

Participants agreed that revenue and employment impact on states is a concern in this debate, though some argued that changes in tax policy may be less of a factor than believed. All agreed that smaller, developing countries have specific issues requiring consideration. One participant analysed digital profit in three categories: IP rent, brand rent, and data rent, and insisted that the principle that data has taxable value should be recognised. Participants largely agreed that more and better data is needed.

Debate rose around the three big approaches to digital taxation. The European DST was criticised for being protectionist, based on a minimum tax threshold, and potentially involving double taxation issues actionable before the ECJ; it was argued that if this approach were to prevail it would be better were it to apply at least at OECD level. Moreover, the UK opposes this approach within the EU. Its own user-based contribution approach, and the USA's marketing intangibles approach were credited for circumventing a thorny debate on source/destination allocation. While the USA had been unwilling to change the transfer pricing model more than marginally, and had rejected discussions of digital taxation under the previous administrations, its recent tax reform had a structural effect causing it to find renewed concern over its own tax base, endorsing BEPS and enacting its own legislation with difficulty (BEAT) to capture additional revenue. The USA is now disposed to tax the digital economy, whereas it is Europeans who are reluctant. One participant strongly defended continuing work on updating current transfer pricing rules as the politically feasible incremental step, and drew attention to the underlying conceptual debate over whether users should be considered sources of value (and therefore be considered for corporate taxation), or providers of data in exchange for services. Others cautioned that the issue might not be resolvable by corporate taxation measures alone, and that following through on these measures might entail having to accept abandoning some local tax policy competition.

▪ Session III – Assessing the institutional framework: participation, incentives and the drivers of cooperation

Speakers examined the institutional framework that has emerged after BEPS and sought to identify further drivers of cooperation. The OECD and the G20 have gained new roles, in part by exploiting the sudden political consensus around ending banking secrecy. While they are impressive achievements of international cooperation, new tax policy instruments raise the question of their inclusivity and efficiency, first numerically speaking, but also notably with regard to developing countries. The EU has emerged as an important agenda setter, but suffers tax policy questions of its own (the DST, legal EU state aid conflicting with new independent arm's length principles in BEPS). NGOs and civil society groups have also emerged and taken active part in the process. Globally, there is an encouraging growing commitment to avoid double non-taxation, but the increasing complexity of the landscape causes uncertainty and unpredictability. Other dangers loom. Poorly designed unilateral action in a tense global context can be used or interpreted as protectionist measures. Moreover, technology's pace may impose speedy responses, which may be equally poorly designed, whereas international coordination is much slower a process. The arm's length standard is no longer fit for purpose and it is unclear what can replace it; perhaps a destination-based cash flow tax or residual taxation. But most options involve some form of modifying allocation, a redistributive problem. The digital economy taxation debate reflects the underlying absence of a strong shared sense of what is value creation and how tax revenues should be shared.

> *"Allocation is the biggest question: who gets what and why?"*

Participants in discussion wrestled with the issue of trust, between all actors and stakeholders: countries, governments, NGOS, tax administrations, and tax paying citizens. The OECD was deemed effective at mitigating double taxation, but less suited to tackling evasion and avoidance; the EU however disappointed in generating cooperation and policy change. A lack of dispute settlement mechanisms incentivises countries to deviate from their commitments, while their necessary complexity in the face of proliferating complex new business models hampers the implementation of the agreed-upon rules. One participant proposed to gametheoretically analyse the situation as a repeated coordination game (but partly exhibiting characteristics of a prisoners' dilemma); another voiced doubts that any perfectly satisfactory answer could be found for the problem of profit allocation. Somewhat incredulously, one participant asked whether a "miracle" had taken place, where a conceptually simple yet vexing problem (banking secrecy) had been resolved by a conjunction of crisis, aligned interests, and a nimble institution which seized the moment.

> *"Tax rules are the cream on the coffee: the business environment is the coffee"*

> *"Have we witnessed a miracle?"*

One participant praised the OECD's method as the most promising, recalling the need to quickly lay down foundational principles in view of the Osaka G20 in June. Another refuted the idea that special rules are needed for the digital economy, and against its current "barter economy" where users trade their data for services under conditions of poor understanding and control, sketched out an alternative economic governance scheme based on individuals possessing their data and monetising it as they wish, a possible basis for a "universal basic data income". One participant drew attention to the intimate proximity between sovereignty and tax policy: whereas its sensitivity had impeded progress, effective international cooperation has vastly improved, flowing down from ministerial level to national tax departments through peer-review mechanisms. While participants agreed that lip service should not be paid to inclusivity and that technical assistance must be provided to countries that require it, there was disagreement on who might provide it best between the OECD and the UN as a better representative of non-OECD countries' interests. The complexity of the system was also a concern for some, though others refuted that a more complex system is necessarily more unfair; one participant highlighted the fact that increased complexity affects workers doubly, by enabling profit-shifting and corporate opacity.

One participant brought up the understudied interaction between tax and competition policy, and warned that the monopolisation of the digital economy was unsustainable. Another remarked that attempts to tax away monopoly profits, using tax policy as a second-best substitute for competition policy because it proved incapable of breaking them up, would test the limits of a fragile system. Another participant contested the characterisation of the digital economy as populated by monopolies, opining that they are instead monopsonies on data buying, and that competition policy is poorly equipped to address such a situation.

Wrap-up

Summing up, one participant returned to the current "miraculous" (and underacknowledged) progress in international tax governance, driven by a nimble institution exploiting a newly salient political urgency, and questioned whether diminished returns should be expected due to the difficult issues lying ahead. Personal taxation reform being difficult enough to elaborate and implement, corporate and digital taxation will be even more so.

Perception of the situation as a zero-sum game might make it difficult to do anything else than tinker with the current framework, while unilateral action is taken and the underlying problems posed by few large tech companies go unaddressed. The participant recalled that these might be better solved if the nexus between tax and competition policy were explored.

In discussion, participants exchanged involving national sovereignty of the implications of monitoring and enforcement and their effectiveness, as well as of interpretations of principles and concepts like value creation, agreeing that some kind or yardstick for profit allocation is sorely needed. One participant welcomed the debate over allocation and value creation, drawing a parallel to the practice of competition policy; the same participant drew a further parallel with climate change action and banking supervision to explore the line between enforcement and monitoring mechanisms. Another participant responded that whereas it is unclear what value creation is, it is becoming clearer what it is not, which was the focus of the earlier iteration of BEPS.

“It is important to have this discussion in tax analysis, similar to the one in competition analysis: what is this profit and what part is legitimate and taxable.”

Some participants reiterated criticism towards the EU, internally paralysed due to leadership dissonance (UK) and its own internal decision procedures (unanimity), and recalled that the current driver of change is, unexpectedly, the Trump administration. One affirmed that whereas the other EU leaders boast concern for tax issues in the G7, their minimum taxation proposal is really meant to counter American designs on the reallocation of taxation, and that it might give rise to race to the bottom problem. They expressed doubts of the existence of a digital economy, arguing that speaking of a digitalization of the economy may be more appropriate, and reminded participants that it is still the USA that is blocking serious work on taxation solutions for inclusive growth and against inequality (capital taxation), as well as for environmental challenges (transport fuels tax); though a recent Republican shift on the subject of carbon taxes may change this. Participants echoed the caution against unconsidered or politically improbable action that could destabilise a fragile system.

Programme

Monday 18 February 2019

19.30	Welcome dinner and keynote address

Tuesday 19 February 2019

09.00 - 09.15	Welcome and Introduction
09.15 – 09.30	Tour de table
09.30 – 11.00	**Session I** - The framework for transparency and exchange of information: achievements and shortcomings
11.00 – 11.30	Coffee break
11.30 – 13.00	**Session II** - Tax coordination and the digital economy: Alternative ways forward
13.00 – 14.30	Lunch
14.30 – 16.00	**Session III** - Assessing the institutional framework: participation, incentives and the drivers of cooperation
16.00 – 16.30	Coffee break
16.30 – 17.00	**Wrap-up** - Lessons for global governance
17.00 – 18.00	Farewell cocktail

Participants

Andrew Auerbach	Organisation for Economic Co-operation and Development
Adrien Bradley	European University Institute
Robert Danon	University of Lausanne
Aisling Donohue	MGPartners
Joachim Englisch	University of Münster
Mateja Vranicar Erman	Ministry of Finance of the Republic of Slovenia
Tatiana Falcão	European University Institute
Itai Grinberg	Georgetown Law School
Pierre Habbard	Organisation for Economic Co-operation and Development
Michel Heijdra	Ministry of Finance of the Netherlands
Julien Jarrige	Organisation for Economic Co-operation and Development
Liselott Kana	Ministry of Finance of Chile
Alain Lamassoure	Member of the European Parliament
Jean-Pierre Lieb	E&Y
Philippe Martin	Sciences Po
Ruth Mason	University of Virginia
Nara Monkam	African Tax Administration Forum
Will Morris	PwC US
Pier Carlo Padoan	Formerly Minister of Economy and Finances of Italy
George Papaconstantinou	European University Institute
Grace Perez-Navarro	Organisation for Economic Co-operation and Development
Carmel Peters	New Zealand Inland Revenue
Jean Pisani-Ferry	European University Institute
Pasquale Pistone	International Bureau of Fiscal Documentation
Stephen Quest	European Commission, Directorate-General of Taxation and Customs Union
Thomas Rixen	University of Bamberg
Pascal Saint-Amans	Organisation for Economic Co-operation and Development
Wayne Swan	Formerly Deputy Prime Minister of Australia
Paul Tang	Member of the European Parliament
Coen Teulings	University of Cambridge
Claire Waysand	Cercle des économistes