THE TRANSFORMATION OF GLOBAL GOVERNANCE PROJECT

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TAXATION GOVERNANCE IN GLOBAL MARKETS: CHALLENGES, RISKS AND OPPORTUNITIES

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Progress in tax governance: a miracle or a new paradigm?

1 **Amongst the different global governance policy areas, tax governance presents a unique contrast**: with taxes at the core of national sovereignty, it would in principle be a particularly difficult area for effective tax coordination and cooperation arrangements to be agreed on and implemented; for decades, indeed, lasting cooperation failures led to ever-increasing tax avoidance. And yet, in practice there has been substantial progress in recent years, and while hard challenges remain to be tackled, international cooperation undoubtedly benefits from a momentum. Some speak of a "miracle"; others of an aberration; or, perhaps, a new paradigm for collective action has started to emerge. Whichever way, there are important broader lessons for global governance to be drawn from the circumstances and methods in which progress has been achieved, as well as from the limits encountered in the search for workable solutions in global tax governance.

2 **Beyond the issue of sovereignty, major obstacles hamper international cooperation in the field of taxation**:

- First, preferences differ across countries as regards both the level and the structure of taxes;
- Second, tax competition pays off: many countries can individually benefit from lowering effective tax rates on highly mobile factors;
- Third, players in the tax competition game are not only countries: we have witnessed the endogeneous emergence of aggressive subnational tax jurisdictions that are not part of the web of international policy cooperation agreements;
- Fourth, the global framework for international coordination is seriously outdated: its essential principles reflect the channels of interdependence that characterised the goods-producing economy of the early 20th century, not today's technology-driven, digital, service-intensive economy; furthermore, it relies on a myriad of heterogeneous bilateral agreements rather than on common rules.

3 **Yet results have been obtained despite all these obstacles**. As far as individuals are concerned, bank secrecy and the resulting evasion from income and wealth taxes is largely a thing of the past: 150 jurisdictions have committed to exchanging information on request and close to 90 participate in automated information exchange through about 4500 bilateral conventions. According to the OECD, bank deposits in international financial centres have decreased by one-third since 2008 and a significant part of this decline is attributable to cross-border information exchange. No equivalent result has been reached as regards multinational corporations, but a structured multilateral process has started within the framework of the *Base Erosion and Profit Shifting* (BEPS) initiative of the OECD. Moreover, discussions are being held on possible cooperative solutions to the tax challenges arising from digitalisation.

How progress was achieved, and where

1 **Progress achieved in the field of bank secrecy was due to a confluence of factors**:

- Acute public finances needs in a series of countries;
- Public opinion pressure for international tax fairness following the crisis;
- A conceptually simple problem to solve (abolishing banking secrecy);
- One country (the US) using its power and extra-territorial reach to impose change;
- An alignment of interests of the largest advanced and emerging sovereigns participating in the G20;
- The existence of a nimble institution which seized the moment (OECD).

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2 **It was a case of unilateralism helping pursue multilateralism**. Intentionally or not, the unilateral US decision to coerce financial institutions to disclose individual data (through the FATCA scheme) resulted in triggering international discussions on a cooperative solution to tax evasion. After the goal of ending bank secrecy was supported by other major economies and endorsed by the G20 in 2008, the (small) veto players that had successfully blocked any agreement within the framework of the EU or the OECD were forced to concede defeat.

3 **The role played by the OECD illustrated how institutions can flexibly serve global governance beyond their formal remit**. The OECD convention does not give it an explicit mandate in the field of taxation and it does specify that all decisions are taken by unanimity by its member countries. And yet, it served as a venue for international tax discussions that included non-member countries and jurisdictions and resulted in overcoming long-standing oppositions to cooperation. Instead of the organisation functioning on the basis of its formal mandate and rules, the OECD secretariat was effectively tasked by the G20 to work in inclusive format and to participate in putting pressure on reluctant players (including some of its members).

4 **Implementation still lags behind commitment**. Despite success in legislating, enforcement and supervision remain problematic, and for a number of countries a lack of capacity building limits the effectiveness of data exchange.

Why corporate taxation and the challenges of digitalisation have not been successfully tackled yet

1 **Efficiency and equity issues raised by reform of the international regime for corporate taxation are an order of magnitude larger**. As far as efficiency is concerned, existing formulas for allocating taxing rights among tax authorities is based on an outdated model of international interdependence. They do not take into account synergies within multinational firms and do not match the actual location of value creation in a world of global value chains, intangible investment and digital presence. But interests are not aligned when it comes to defining methods to apportion profits or determine where value is being created in a digitalised economy. As far as equity is concerned, reform is bound to raise major distributional conflicts: while ending bank secrecy only resulted in losses for wealthy individuals and a few tax havens, a comprehensive solution to corporate tax avoidance will create winners and losers amongst major countries. Against this background, the BEPS framework has helped improving transparency and curbing the development of preferential tax regimes, but progress towards tackling tax avoidance has been limited thus far.

2 **The way forward is not to separate out the taxation of digital services, but to redefine principles and instruments for corporate income taxation in a globalised, digital economy.** Problems with taxing providers of digital services are not fundamentally different from those when taxing other multinational companies. They are just bigger and more visible. Concepts underlying the international tax cooperation regime (such as that of permanent establishment) or instruments tax authorities rely on (such as transfer prices) are fatally outdated. What is needed is a radically new set of principles and instruments for today’s global economy.

3 **Whether or not the international community is able to rise to these challenges will have deep consequences for efficiency, equity and the legitimacy of globalisation**. The issue of global corporate taxation is not a technical issue for specialists anymore. It affects business models and internationalisation patterns. And as citizens worldwide are now acutely aware of the problem, failure to tackle it undermines support for continued international economic integration.

4 **It is possible, but by no means certain, that unilateral action will again help unlock multilateral discussions**. Though their motivations and stances towards international cooperation differ markedly, the Trump administration’s decision to effectively impose a minimum taxation on the global income of US multinationals (through the BEAT and GILTI schemes) may be a game-changer in the same way the Obama’s decision on FATCA was instrumental to end bank secrecy. After it has lowered the corporate income tax rate markedly, the US government has now a vested interest in taxing all multinational companies, including the digital ones.

5 **The outcome of this discussion will also have institutional implications for the governance of globalisation**. For some, the current framework of tax cooperation provides a template for achieving results in other fields. For others, it is an idiosyncratic setup, useful in exploring solutions in increasingly intractable tax areas, but exhibiting problems in enforcement and monitoring, with effectiveness already showing diminishing returns, and difficult to replicate in other policy areas.