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Extending the G20 Tax Mandate

by

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The Cairns G20 Summit communiqué (paragraph 8) contained one paragraph on tax which reconfirms the G20 commitment to the broad policy principles behind the BEPS project, without being too specific, and to making automatic exchange of information the new international standard. Firm actions on BEPS, however, will have to wait until the 2015 Summit - since nothing is agreed until everything is agreed.

What most commentators have missed in their reading of the Cairns communiqué is the way that it extends the G20 tax work. This omission may reflect the fact that these proposals were tucked away in an annex. So what new mandates are there in this annex?

Growth Promoting Tax Reform

From the perspective of business and government, the most important new mandate is to look at how tax systems can promote growth. It is worthwhile quoting from the communiqué under Issues for Further Action, "We ask the IMF to work with the OECD, in consultation with other relevant international organizations, to analyze the implications of the tax policy mix and composition of government expenditure for growth outcomes."

I see this as recognition, belatedly, by Finance Ministers that the exchange of information, transparency and the base erosion agenda whilst important to protect the tax base and to provide a level playing field, does little to address the broader issue of promoting growth.

The three page background paper prepared by the IMF, "Growth Friendly Fiscal Policy," (view here) and which provides the basis from this new mandate picks up the analysis and recommendations made by the OECD in its 2010 report on how to design pro-growth tax systems, namely:

1. The need to reduce corporate and personal income tax rates and compensate for the revenue loss by broadening the tax base.
2. The recognition that moving VAT systems towards a low rate that applies across a broad range of goods and services can stimulate growth.
3. The way in which a shift from direct taxes on income and profits to taxes on consumption and immovable property could increase growth.

These proposals did influence tax policy in many countries but over the last two years we have seen some back sliding with some countries increasing their rates and introducing new preferential new tax regimes. Also, there has been little progress in revisiting exemptions and zero ratings under VAT regimes. Similarly, there has been a lack of political will to undertake a comprehensive review of the way the tax systems apply to land and buildings, not just traditional property taxes, but also other taxes which apply to property such as VAT and transaction taxes.

Hopefully, this initiative by the G20 will give a new political impetus to achieving growth enhancing structural changes in our tax systems, although any such recommendations will also have to address the issue of how such policies can be reconciled with the need to use tax systems to achieve a fair distribution of the tax systems (the Thomas Piketty debate).

The Use of Tax Incentives

A second new mandate is to "prepare options for an efficient and effective use of tax incentives in low income countries." The IMF, OECD, UN and World Bank are asked to report back on this mandate by 2015. In fact, all of these organizations have, for many years, worked

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on tax incentives and have a common position: countries should be cautious of using tax incentives to attract FDI and stimulate specific sectors (although well targeted incentives in the area of R&D are acknowledged as potentially useful). Despite this common position, very few countries have taken into account this advice and over the last decade we have seen a proliferation of tax incentives and specific preferential tax regimes: what some NGOs have dubbed as a "race to the bottom." Given the language used in the mandate, I suspect that the emphasis will not be on how to remove incentives (all G20 countries use tax incentives extensively) but on how to improve their transparency, how to make them more accountable by incorporating them into the normal budgetary process and how to evaluate their impact. There is also no reason why any policy recommendations from such a study should be directed at just low income countries as almost all OECD countries also use incentives.

One intriguing aspect of the new mandate will be to see how it links to action five of the BEPS project, which is intended to curb harmful preferential tax regimes. Clearly, there is a link since such regimes are by definition tax incentives, although the OECD 1998 Report on Harmful Tax Competition (which forms the starting point of action five) is limited to the financial and service sector; but the issues raised for FDI are similar. Also low income countries are tempted to use these incentives, not just to attract FDI, but also to attract "footless" service and financial activities.

Conclusions

The new project could be seen as implicitly extending the scope of action five so that it addresses one of the major concerns by developing countries - namely that the BEPS is not targeting tax incentives that are used to compete for FDIs.

The two new mandates, combined with the emphasis on how to build capacity in tax administrations in developing countries, will go some way to address the concerns of these countries. On this last point it is also noteworthy that the G20 has called for international organizations "to develop a new structural dialogue process with clear avenues for developing countries to work together and direct the input into the G20/OECD BEPS project." The reference to "structural dialogue" seeks to address the feeling among LDCs that whilst the OECD has sought their views, they are not part of the decision making process and a feeling that whilst India and China have as seat at the G20 table, there is not necessarily an alignment between their interests and those of typically developed countries.

The most effective way to achieve a real voice in developing countries may be to use the UN tax committee and have a series of joint meetings between that committee (or its subgroup on BEPS) and the extended Committee on Fiscal Affairs.

When the G20 leaders meet in Brisbane in November, it will be interesting to see how far they focus on some of the broader issues raised in the Cairns communiqué.