The limits of international cooperation on tax

Blog post by Head of Europe Tom White, 18 December 2017

One of the clichés in international cooperation is that national governments' enthusiasm for sharing cost centres evaporates when talk turns to sharing profit centres. This explains the imbalance between joint investment in basic research and national commercial application of R&D, or the discrepancy between joint telecoms standards and ruthless national auctions for mobile phone spectrum. But it is the technocratic world of tax administration that traditionally exposes this most bluntly, with the need to raise revenue and to attract capital investment outweigh the desire for efficiency and fairness between national finance ministries. The final months of 2017 have delivered stark reminders that while the negative-sum game of tax secrecy may be ending, the incentives to play the negative-sum game of tax competition remain too strong for governments to resist.

European and US governments have shown remarkable political ambition since 2011, accelerated by the shared sense of outrage following the Lux Leaks, Panama Papers and Paradise Papers tax avoidance scandals, to establish automatic exchange of information about one another's taxpayers. They have joined forces to twist the arms of smaller jurisdictions to follow, the success of which was evident in the small number of remaining 'non cooperative' jurisdictions in the EU's latest blacklist. These are not bland commitments to transparency: EU Member States began automatic sharing of detailed personal tax information under the Administrative Cooperation Directive in September 2017, and almost all other developed and emerging economies will do so under the OECD Common Reporting Standard by the end of 2018.

In 2015 it appeared that similar momentum could carry through to the design of taxes themselves. The OECD's principles on 'Base Erosion and Profit Shifting' set agreed limits on the tax privileges that governments could offer to internationally mobile companies, codified in the EU's anti-tax avoidance directive. This political will was driven by a sense that true sovereignty over tax and spending – especially at a time of fiscal consolidation - required fair enforcement of each country's rules, blurring longstanding principles of directly accountable democratic control over tax raising, and even overturning constitutional protections in some countries for confidentiality of personal financial information.

However, there are clear signs that BEPS was a high water mark, rather than a milestone on the way to an international system of tax governance. Failure to agree a Financial Transactions Tax even between the 11 (now 10) participating Eurozone countries, the scaling back of plans for a 'digital tax' in the EU under threat of national vetoes, and a US tax reform package that explicitly encourages the reshoring of economic activity, all indicate national governments will ultimately act alone to increase their shares of a now-growing global economy. A consensus to 'tax the untaxed' is one thing; it is another to develop a fairer system for deciding *where* activities are taxed, if that risks losing revenue and losing control over collecting that revenue.

As advocates of further international standards seek successful precedents for joint design of tax instruments, the EU's system of (mostly) harmonised Value Added Tax is instructive. The risks of leakage and fraud in consumption taxes for cross-border purchases forced Member States to overcome misgivings about sharing revenue. They agreed to bind themselves into fixed bands for tax rates, with the release valve of national exemptions for sensitive products agreed at the outset. As political momentum stutters for similar work on direct taxes, an important lesson for plans such as the EU's Common Consolidated Corporate Tax Base is to build in sufficient carve outs to ensure a clear net benefit for all participants to scale back tax competition, as any loser from a new system will not hesitate to wield a veto.