THE ROLE OF TAX CERTAINTY IN PROMOTING SUSTAINABLE AND INCLUSIVE GROWTH

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Tax certainty is a key component of a good tax system. It helps to reconcile the expectations of taxpayers and governments and provide a tax environment which is conducive to growth and FDI. Achieving tax certainty in developed and developing countries is more difficult now than in the past since there is a climate of mistrust between society and MNEs which has led to a conflictual environment between the wider public, business and governments over tax policy and implementation. Nevertheless, in the long term, it is in the interest of both government and business to minimize as far as possible tax uncertainty.¹

I. Key Concepts

A number of concepts are relevant when considering how tax certainty can be achieved. The first is what the definition of tax certainty is. Tax certainty can only be achieved when the right balance is struck between facilitating compliance, identifying, and curbing aggressive tax planning. Three concepts can be defined:

- **Tax certainty**: The capacity to make an **accurate assessment** of the tax and compliance costs associated with an investment or a continuation of an investment in a country over the lifecycle of the investment/company.

- **Compliance by taxpayers**: Voluntary **behaviour by companies** in a way that both respects the letter and the spirit of the law and which is in accordance with the intention of the legislator.

- **Aggressive tax planning**: An intentional use of the tax law or a combination of tax laws and/or tax treaties in a way that leads to taxation not in line with the spirit and purpose of the relevant tax laws.

II. The current political, economic and tax environment

Today’s environment for FDI is characterised by high levels of political and economic uncertainty, including in the area of tax reform (see Chart 1.)

¹ See “Update on Tax Certainty: IMF/OECD Report for the G20 Finance Ministers and Central Bank Governors, July 2018
Chart 1: Long term drivers of policy reform – key points

The political climate is tense: As political and economic power shifts from the West to the East; as the USA follows a policy of “America first” and undermining international institutions; as China, the EU and the US compete for influences in the developing world; as politicians follow rather than lead public opinion (a trend encouraged by the use of new technologies and social media) and the rise of populism; as more and more countries experience a backlash against globalisation and the role of MNEs; all increase political tensions within the global economy.

The economic recovery is fragile: In the latest economic outlooks from the OECD and the IMF, the forecast for world growth have been lowered. FDI is still below trend level prior to the 2007 crash. Growth in trade is below growth in GDP. It looks increasingly unlikely that a major trade war can be avoided; concerns abound on the high level of public and private debt. Overall, there is an emerging consensus that the current economic recovery is fragile.
Growing inequalities in the distribution of income and wealth: although globalisation has lifted almost a billion people out of poverty and reduced inequalities between countries over the last three decades, inequalities in the distribution of income and wealth within countries has increased. Studies by the OECD and IMF have shown that this may be having a negative impact on achieving sustainable growth since with the breakup of social cohesion it is more difficult to build political support for structural reform.

Chart 2: Rising inequality, falling real incomes

- In many major economies, inequality has increased and households have experienced much slower growth in real incomes since the crisis.

(Extracted from Mr. Carlo Lobo’s slide on “The Future of CIT and the Tax Function” at the 2nd Tallinn Tax Conference, September 2018, Tallinn, Estonia)

Government budget continues to be under pressure: On the expenditure side, the ageing of the population, advances in medical technology, fighting terrorism, replacing an ageing infrastructure are all putting pressure on government expenditures. At the same time, there are pressures on the revenue side. Governments get the bulk of their tax revenues from taxes on employment, consumption and profits. All of these tax bases are being challenged by changes in employment patterns (shared economy and the rise of robotics), the digitalisation of our economies, the development of 3D printing, and new business models.
Also, the OECD led BEPS project is creating tax uncertainty, Chart 3 shows that corporate tax systems are subject to both short and long term pressures.

### III. Fundamental requirements for tax certainty

Achieving tax certainty is difficult in a complex world, particularly when considering that large MNE groups have sophisticated global value chains and taxes are levied at a country level, based on local legislation, culture, economic circumstances and political context. In a post BEPS world, this is even more difficult, at least in the transitional period as we move from the old order to new order.

Chart 4 sets out what business sees as the top 10 sources of tax uncertainty.
1. How can the design of tax legislation foster tax certainty?

Some key requirements are:

- The legislation is unambiguous and clear, leaving no or little room for unintended misinterpretation;
- The legislation realizes the policy aims determined by the government;
- The law is designed to minimize administrative costs, striking the right balance between tax compliance and the burden on taxpayers;
- The legislation will be as much as possible be in line with international standards and best practices, both in terms of content and administrative practice (this includes avoidance of double taxation, not imposing unnecessary compliance costs on cross border activities, and preventing harmful tax competition);
- Legalization needs to be based upon a “principle” based approach.

2. What key features should a tax administration undertake to promote tax certainty:

- Incentivized and capable to apply the tax legislation in accordance with the letter and spirit of the law;
- Supported by efficient and effective administrative and IT processes;
• Social skills and tools to ensure compliant taxpayers are served as efficiently as possible by providing clarity on the taxation positions in as early as possible a stage;
• Guidelines, safeguards, tools and skills to ensure that non-compliant taxpayers are identified and appropriately curbed;
• The response of the tax administration should be proportional to the behaviour of the taxpayers;
• Checks and balances should be in place to ensure that the elements above are continuously guaranteed, including through the availability of mediation processes and well-functioning administrative and judicial appeal procedures.
• Establish metrics for evaluating measures of success in achieving high compliance that go beyond simple revenue yield measure;

3. What behaviour of taxpayers is required:
• Introduction of a well-functioning tax control framework, which:
  o Links business reality with tax compliance;
  o Ensures the availability of the right information at the right time;
  o Ensures that this information is provided to the tax administrations when required;
  o Ensures that the taxes are paid at the right time and in the right place.

4. Tax incentives needs to be designed in ways which minimize tax uncertainty by:
• Avoid discretionary incentives;
• Avoid incentives outside the control of the Ministry of Finance;
• Make all tax incentives subject to regular evaluation and transparency.

IV. Measures that can be taken to improve tax certainty

A. How can governments provide greater tax certainty?

In a complex economic environment, it is unrealistic to expect perfect tax certainty. There will always be room for different interpretations of the law and in some situations, uncertainty may be attractive to government and business. This section sets out what government and business can do to achieve greater tax certainty:

a) At the level of policy and implementation
• Engage business and other stakeholders both in policy formulation and drafting of legislation
• Ensure tax policy makers and tax administrations are working together to formulate new policies
• Establish transparent and open consultation processes
• Issue white papers that enable input from a wide variety of stakeholders before legislation is finalized

b) Draft legislations in clear and unambiguous ways
• For example, all legislations can be formulated in a draft form and go through a process of consultation.
• Ensure the purpose of specific sections of the law are clearly stated so that taxpayers and the courts have a clear basis for interpreting the more detailed and technical provisions (principles-based legislation).

c) Be prepared to issue clarifications and public rulings that are binding on the tax administration.
d) Avoid as far as possible retroactive legislation.
e) Centralize all large business cases into a large business unit so as to achieve a consistent application of the rules throughout the country.
f) Issue clear guidance to regional tax offices on how they can apply legislation and tax treaties and regularly monitor that this guidance is followed.
g) Explore all the options to resolve issues and questions prior to the submission of a tax return or an audit. This can be done by the use of pre-audit programs such as the US CAP and the use of Cooperative Compliance.
h) Use a variety of methods to increase the awareness of tax officials on the way business models are evolving and the speed of change. This could take the form of regular meetings between business and tax officials, briefings by business to senior executives in the tax administration, and rotation of staff between MNEs and tax administrations.
i) Implement bilateral/multilateral APAs and rulings targeting large MNEs in the top sectors in the economy and use the new ICAP procedures proposed by OECD.
j) Eliminate discretionary tax incentives, and centralize decisions in MOF on the provision of incentives, and carefully monitor the cost to revenue after implementation.
k) Identify key gaps in the tax treaty network in term of strategically important countries which currently lack tax treaties.
l) Review existing tax treaty policy to identify where it needs to be updated to reflect the best current practices whether developed by UN or OECD and develop a clear method for assessing the costs and benefits of entering into a treaty or...
whether not to have treaties and rely on domestic legislation. Use the newly
developed multilateral instrument (MLI) to update existing treaties.

m) Examine policies towards resolving cross border tax disputes, including through
the use of mediation and mandatory dispute settlement mechanism

n) Fight corruption and look at the pay structure of tax officials; too often bribes can
be a way to “buy” certainty.

Chart 5 sets out what measures business would like to see to reduce tax uncertainty. Priorities between
these actions may differ between developed and developing countries.

**Chart 5: The recommendations of business to achieve greater certainty**

![Bar chart showing tax policy design and legislation](image)

(Based on a 2016 business tax certainty survey carried out by the OECD and BIAC.)

**B. MNEs could also take measures to reduce tax uncertainty:**

a) Respect both the spirit and the letter of the law as set out in the [OECD Guidelines for Multinational Enterprises](https://www.oecd.org/tax/).

b) Provide accurate, full, timely information to tax authorities to enable them to have
complete understanding of business and tax strategies. This would be consistent
with the current trend of Country-by-Country-Reporting (CBCR), the use of
master and local files and domestic provisions requiring the disclosure of tax
avoidance schemes and uncertain tax positions.

c) Be prepared to enter into Cooperative Compliance programs, ICAP, multilateral
APA and rulings.
d) Ensure the consistency of information provided to different tax authorities around the world.

e) Appoint a global tax policy senior executive to oversee the company’s global tax strategy.

V. Conclusion

Eliminating excessive tax uncertainty is in the interest of both government and business, especially in the current, very uncertain economic and political environment, and is particularly important for economies in transition and developing countries. Achieving this will require unprecedented cooperation between businesses and government.