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WORLDWIDE TREND IN TAXATION

Summary: The purpose of this paper is to analyse the direction of trends in the tax systems. The first part analyses the influence of globalisation on tax policy, the second one describes a phenomenon of international tax competition and the next introduces and evaluates the calibre of the current proposals to tackle tax competition, especially its harmful consequences. Governments around the world have pursued differenet economic policies. That diversity has created a wide range of economic outcomes – from glittering prosperity in some nations to abject poverty in others. Over the time, it has become clearer what sorts of economic policies, including tax policies, should be pursued to improve living standards.

Keywords: tax policy, fiscal burdens, tax competition, globalisation.

1. Globalisation and Tax Policy

Economic, demographic, institutional and technological changes are constantly occurring throughout the world. Since a few years we have been able to talk about global economy which has a great impact on the national economies. Globalisation can be a threat or an opportunity, depending on a country's trade mix and its economic and regulatory structure.

Globalization, defined as increasing trade and financial openness, has increased significantly over the past two decades, with a particularly sharp pickup in capital flows (or financial globalization) in recent years. This has been accompanied by financial deepening as the financial sector has grown in economic importance. The ability of capital to move to where it can be used most productively, together with deeper domestic financial markets, can increase economy's efficiency and growth potential. However, globalization and financial deepening can have consequences that require appropriate policy responses if higher growth is to materialize, and the ability to respond in part depends on how these developments affect the government's policy choices, including its fiscal policy options[1].

This in turn should shift their tax revenue from "easy to collect" taxes (tariffs and seigniorage) towards "hard to collect" taxes (value added and income taxes). In

[1] *Globalization, Financial Markets, and Fiscal Policy*, ed. T. Ter-Minassian, Fiscal Affairs Department, International Monetary Fund, 16 November 2007, p. 5.

the short run, many of these changes are beyond the control of a country, but they cannot be ignored in the development of any effective fiscal policy. In the longer-run, government policy itself may impact some of these economic and demographic trends. At the same time, the institutional factors that govern a country and the technological changes faced by all countries are also important in terms of their impact on fiscal policy.

These changes imply pressure for public expenditures that are different depending on the type of occurring of economic and demographic change. At the same time, the capacity of traditional revenue sources is affected by similar factors.

Present tax systems evolved when every country formulated its own tax policy and focused on the requirements of its domestic economy. When tax treaties, agreements and conventions among nations were negotiated, they were within the framework of national sovereignty in tax policy. The globalization process has changed this, particularly with respect to the level of taxation, mix of taxes, design of particular taxes, and the manner of their administration and compliance. Countries are being forced to exhibit much greater awareness and sensitivity to the tax changes being undertaken by their trading partners and competitors, reducing autonomy concerning their tax policies[2].

Tanzi uses the term "fiscal termites" to depict how globalization and technological changes will impact on national tax systems. These "termites" result from the interplay of globalization, tax competition and new technologies. Like biological termites, fiscal termites are weakening the foundations of current tax systems. They are making it progressively more difficult for countries to maintain high levels of taxation. The evidence of their presence is seen almost daily. According to Tanzi fiscal termites are as follows:

– electronic commerce,
– electronic money,
– transactions that take place between different parts of the same multinational enterprises (i.e., intra-company transactions),
– rapid growth of off-shore financial centres and tax havens[3],
– exotic and complex financial instruments that continually enter the financial market.

In addition to the termites mentioned above, there are other developments that would merit to be added to the above list. Furthermore, it is possible that some of the above termites may combine or mutate to create even greater difficulties. These developments will, over the years, have a progressively larger impact on: (a) tax revenue, (b) tax structures, and (c) the use of particular tax bases. The net result will be a world with lower tax revenue and different tax systems[4].

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[2] Ibidem.

[3] V. Tanzi, *Globalization, Technological Developments and the Work of Fiscal Termites*, International Monetarny Fund, Working Paper, November 2000, p. 4-15.

[4] V. Tanzi, *Globalization, Tax System, and the Architecture of the Global Economic System*, www.iadb.org

Every process has negative and positive aspects. The same situation is in the field of taxation. A few years ago R. Neumann, J. Holman and J. Alm suggested that empirical evidence on the impact of globalization on tax policy remained quite mixed. Although – according to them, there have been some changes in the tax policies along the predicted line, to date these changes – on the level of collection, the composition of revenues, the convergence in tax rates – have become minimal[5].

Currently they present quite opposite view, in spite of the date for the past years. According to them common perception is that globalisation implies that governments lose their ability to choose tax policies independently of other juristiction – in course of increase tax competition or increase tax harmonization. The level of tax rates is likely to decline. We can expect the changes in the composition of taxes, and jurisdictions cannot set tax goals and rates independently of other jurisdictions[6].

Tanzi has not doubt, globalization tends to put downward pressure on the level of taxation. There are many reasons for this. First, globalization and the opening of economies requires that foreign trade taxes be eliminated. Second, international tax competition has generated a significant reduction in the marginal tax rates for personal income taxes and for corporate taxes. Third, the mobility of financial capital is forcing countries to reduce taxes on this importanat tax base. In some countries this has led to the intruduction of the dual income tax that taxes financial capital at lower rates. Fourth, it has become difficult for countries to put high tax rates on luxury products because of facility for individuals to get these products from a country where the rates are low[7]. Theories may experience cycles just as economies do[8].

It is really hard to say which changes in taxation were provoked strictly by globalisation but tax reform is an on-going process. Tax system reflects changing economic, social and political circumstances. Over the last two decades, almost all OECD countries have undertaken structural changes to their tax system which have significantly altered the way these systems function and their economic and social impacts.

In some countries, for example, many of the Eastern European economies in transition, the reforms have been profound and implemented over a very short period of time. In others, most of the European countries, the reforms have been a gradual process of adaptation but which over time have substantially redesigned their tax systems. One can argue whether the second group of countries can be characterized

[5] R. Neumann, J. Holman, J. Alm, *Globalisation and Tax Policy*, Andrew Young School of Policy Studies, Georgia State University, January 2003, p. 2-5.

[6] R. Neumann, J. Holman, J. Alm, *Globalisation and Tax Policy*, VERC Conference on the Implications of Integration for Globalization, Wilfrid Laurier University, 30 April-1 May 2008.

[7] V. Tanzi, *Globalization and the Need for Fiscal Reform in Developing Countries*, Occasional Paper, IDB-INTAL, Buenos Aires 2004, p. 12.

[8] V. Tanzi, *Fiscal Policy and Fiscal Rules in the European Union*, Centre for Social and Economic Research, Studies & Analyses No. 301, Warsaw June 2005, p. 13.

as having undertaken "fundamental" tax reform (see **Table 1**). Few would disagree that the tax systems in operation in the 30 OECD member states are today truly fundamentally different from those which operated in the mid-1980's[9].

Table 1. Reducing tax rates – the most common reform feature in 2007 and 2008

Reduced profit tax rates	Albania, Antigua and Barbuda, Bosnia and Herzegovina, Burkina Faso, Canada, China, Côte D'Ivoire, Czech Republic, Denmark, Dominican Republic, Georgia, Germany, Italy, former Yugoslav Republic of Macedonia, Madagascar, Malyasia, Morocco, New Zealand, Samoa, St. Vincent and the Grenadines, Thailand
Simplified process of paying taxes	Azerbaijan, Belarus, China, Colombia, Dominican Republic, France, Greece, Honduras, Malaysia, Mozambique, Tunisia, Ukraine
Eliminated taxes	Belarus, Dominican Republic, Georgia, Madagascar, Malaysia, Mexico, South Africa, Uruguay
Revised tax code	Bosnia and Herzegovina, Bulgaria, Morocco, Mozambique, Zambia
Reduced labour tax or contribution rates	France, Mongolia, Ukraine

Source: *Paying Taxes 2009. The global picture.* PriceWaterHouseCoopers and World Bank, p. 11.

These tax reforms have been driven by the need to provide a more competitive fiscal environment. Almost all the tax reforms of the last two decades involving the income tax can be characterized as tax rate reducing and tax base broadening reforms. Revenue authorities around the world are making great efforts to streamline administrative processes and modernise payment systems. According to *Doing Business* there has been 126 reforms in the past four years aimed at reducing tax rates or the time or cost to comply with tax laws. The reduction of corporate income tax rates has been, however, the most popular reform feature. More than 60 economies have done this[10].

The idea that European countries are forced to reduce their corporate tax rate to attract foreign investment (small countries) or to limit the capital drain (large countries) is widespread. And yet, businessmen do not report corporate tax rates as a leading factor in their decision to invest in a country[11].

As a matter of tax rate reduction – the top personal income tax rate was 73% in 1986 and 63% in 2005. However, the rates continue to be rather high. The corporate tax rate has declined as well. It currently has a rate equal to 28% (coming down from

[9] J. Owens, *Fundamental Tax Reform: an International Perspective*, OECD's Centre for Tax Policy and Administration, www.oecd.org/ctp.

[10] *Paying Taxes 2009. The global picture*, PriceWaterHouseCoopers and World Bank, p.13.

[11] A. Bénassy-Quéré, N. Gobalraja, A. Trannoy, *Tax and Public Input Competition*, CEPII, Working Paper No 2005, 2008, p. 3.

50% at the beginning of the 1990s). Indirect taxes have been decreasing over time as a response to cross-border shopping and as the EU's indirect tax harmonization rules[12].

The Italian government reduced its corporate tax rate from 36% in 2002 to 33% in 2004. Also the personal income tax rates decreased: the top personal income tax rate from 45.5% in 2000 to 43% in 2005. Moreover, the new tax allowance scheme reduced the personal income tax burden for low-income families and for many middle-income ones. The Italian corporate tax reform slightly increased the corporate tax burden. However, the corporate tax burden was decreased for firms belonging to a group that chose tax consolidation[13].

Personal income tax rates were reduced in the Slovak Republic. The five income brackets – rates varying from 10% to 38% – were replaced by a single rate of 19%. The corporate tax rate of 25% was reduced to 19% as well. Dividends are no longer taxed at the household level. Moreover, the general VAT rate was reduced from 20 to 19%. The low VAT rate of 14%, however, was abolished. In Turkey, both corporate and personal income tax rates are around the OECD-average level. The recent reform has abolished the surcharge on the corporate tax. The introduction of the new partial inclusion system implies a significant reduction in the total tax burden on corporate profits gradually from 65 to 44% in 2005[14].

As a matter of tax-base broadening, in Denmark the personal income tax base has been broadened over time. Even though the corporate income tax rate has been reduced considerably, corporate tax revenues in Denmark have been increasing as a result of corporate base broadening measures (for instance, because of the new joint-taxation corporate tax rules). The introduction of the flat tax in the Slovak Republic was combined with a significant elimination of tax relief measures, which led to a considerable broadening of the personal income tax base. Also the corporate income tax base has been broadened, for instance by abolishing the exemptions for newly established firms. The Turkish tax reform has simplified and reduced the investment tax allowance. Several other tax incentives and exemptions have been rationalized. This has contributed to a broader tax base, and has resulted in a simpler and more transparent tax system[15].

2. Economic aspects *versus* moral case of tax competition

The purchase of goods and services, locations to invest, and places to work and retire; these choices often spill across national borders, as firms and households seek to buy at the lowest price, to sell at the highest price, to invest at the preferred

[12] *Tax Policy Conclusions*, Centre for Tax Policy and Administration, OECD, 2007, p. 6.

[13] Ibidem, p. 11.

[14] Ibidem, p. 11.

[15] Ibidem, p. 7.

combination of risk and return, and to live in communities that best meet their needs. In the long run, more efficient economies and better living standards are the outcome of greater choice. Along the way, however, there are numerous social challenges. Among these challenges there is a threat to customary systems of taxation.

Tax competition is all about choice and that makes it similar to the competition in the marketplace for goods and services. In the marketplace people compare the costs and benefits of products when they decide what to buy. Consumer choice encourages businesses to produce efficiently and to respond to the real need of individuals. Tax competition does the same thing for governments. By limiting the ability of politicians to raise taxes, it encourages them to implement better tax policies and be more frugal with taxpayer money.

According to Ch. Tiebout competition between local governments for mobile households enhances society's welfare. Competition encourages governments to tailor spending and taxation to suit local preferences. Individuals will migrate between jurisdictions based on their demand for government services relative to tax level. Households that want expansive government services can choose to live in jurisdictions with higher taxes. Others will choose to live in jurisdictions with lower taxes and more limited services[16].

Tiebout's theory focuses on local governments, but national governments have become more like local governments as a result of globalization. According to Ch. Edwards and D.J. Mitchell globalization has started to change the relationship between governments and taxpayers. Taxpayers like workers, investors and businesses that do not like the fiscal deal they receive from their governments can pursue better options elsewhere. That has prompted governments to implement tax reforms. In this sense globalization is a positive force bringing competitive discipline to governments. Tax rate cuts are spreading across the globe, and flat tax are being adopted in a growing number of countries. Without tax competition, nation might still be imposing individual income tax rate of 70% and corporate tax rates as high as 50% [17].

However, globalization has numerous critics. The critics want to restrict tax competition and some of them claim that Tiebout was wrong, and that tax competition is demaging to the economy and to governments[18].

The main economic arguments against tax competition are as follows. The first is the notion that tax competition causes inefficiency in the private sector because it drives resources from high-tax to low-tax countries. According to this view, any tax-motivated movement of investment capital or skilled labour between countries is economically harmful. The second argument is that tax competition causes inefficiency in the public sector. In this sense tax competition is said to cause a "race

[16] Ch. Tiebout, *A Pure Theory of Local Expenditure*, "Journal of Political Economy" 1956, No. 64, p. 416-424.

[17] Ch. Edwards and D.J. Mitchell, *Global Tax Revolution. The Rise of Tax Competition and the Battle to Defend It*, CATO Institute, Washington 2008, p. 134, p. 153.

[18] J.D. Wilson, *Theories of Tax Competition*, "National Tax Journal" 1999, No. 52, p. 269-304.

to the bottom" in the tax level. If tax competition continues, governments will not have enough money to fund essential public service.

Over recent years the OECD and member states have been taking aim at tax havens and areas that engage in harmful tax competition. To understand what the OECD is concerned about first it is necessary to understand what is considered harmful tax competition and a tax haven. According to J. Owens: "The main factors for being a tax haven are a) no or only nominal effective tax rates, b) lack of effective exchange of information, c) lack of transparency and d) absence of a requirement of substantial activities". Owens goes on to identify the factors of a harmful preferential tax regime as having the following: "a) no or low effective tax rates, b) 'ring fencing' of regimes, c) lack of transparency and d) lack of effective exchange of information"[19].

The OECD argues that in simplistic terms the taxpayer might consider tax competition a good choice since conceivably tax rates will decrease. In fact this competition increases compliance costs, thus reducing tax savings. Instead of tax revenues moving to the government, substantial portions are diverted to the service industries for work that might be unnecessary given a less complex tax code. Furthermore, increased complexity and compliance costs usually result in an increase in tax evasion and reduced tax revenue collections, which cause a lot of other problems for governments and society.

Opponents claim that the OECD is attempting to make it less attractive for investors to operate in smaller, less developed nations that might offer these tax incentives. The issue often focuses around the argument that multinationals take advantage of smaller nations as opposed to the idea that larger nations make it more difficult for these smaller nations to compete for the business of multinationals. Additionally many small nations that the OECD considers tax havens or engaged in harmful preferential tax regimes rely a great deal on the business generated from these multinationals. If this source of income is diverted back to G-8 or OECD countries, these G-8 countries may find themselves supporting the financial aid and incentives of these small countries that are financially weaker and less politically stable. M. Godfrey refers to the concept of "Fiscal Colonialism". He states that OECD will not find it so easy to continue with international policies designed to protect the tax base in rich countries through a programme of what has been called "fiscal colonialism" aimed at discomfiting the offshore tax havens"[20].

The second problem consists in inefficiency in funding essential public service and protection. This is a huge problem especially for Europe. Nowadays all European countries and many other countries around the world provide workers, old aged residents and survivors' pensions as well as those who sustained work-related

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[19] J. Owens, *Harmful Tax Competition*, [in:] *The OECD's Report On Harmful Tax Competition*, ed. J.M. Weiner, H.J. Ault, "National Tax Journal" September 1998, Vol. 51, No. 3, p. 601-608; Harmful Tax Competition, An Emerging Global Issue, OECD, 1998.

[20] M. Godfrey, *Is the US Treasury Department Poised To Distance Itself From OECD Blacklist?*, Center for Freedom and Prosperity, Tax-News.com.

injuries and disabilities with public service and protection. Social protection covers various policies adopted by governments to protect citizens against several risks connected with economic consequences; or at least policies adopted to help citizens to better cope with these risks[21]. One of the main instruments to enhance the above mentioned protection are tax revenues. In most countries epecially in Europe there are some characteristic movements to protect the level of tax revenues. Since a few years we have been observing the shift towards indirect tax. According to KPMG[22] the shift towards indirect tax is occurring in a number of ways.

Firstly average VAT/GST rates are remaining very stable, and in some cases they begin to have an upward trend, while the headline corporate tax rates fall. As the economy grows, the net effect is that the proportion of tax being collected from indirect tax increases.

Secondly, new indirect tax regimes are being introduced throughout the world (e.g. the Gulf region, India and China) as these jurisdictions modernize their tax systems. The number of countries with national VAT/GST systems is now over 150 and it rises annually.

Thirdly, there is a significant reform of existing indirect regimes with a view to protecting and broadening the base to which the tax is applied. The actions being taken by the EU Commission, EU governments and tax authorities in combating VAT fraud and broadening the charge to VAT on services supplied from outside the EU are clear evidence in this regard.

But the steps towards indirect taxes are not be sufficient. In 2004, the share of public spending of the general government into gross domestic product exceeded 55% in Sweden and Denmark and 50% in France, Finland, and Austria. Ten years earlier these proportions had been much higher having exceeded or approached 60% of GDP in Sweden and Denmark. In 2004 in Italy that share was marginally above 48% and it was partly due to the interest payments of the large public debt and the exceptionally high level of pension payments[23].

3. Summary

The acceleration of globalisation over the past decade has not created any new issues for Europe, but it has raised the stakes on some old ones. In particular, it has put a premium on flexibility and innovation. Coping with globalisation is about coping with change. Flexible product and labour markets, social policies, active labour market support and well-developed capital markets are necessary to keep adjustment

[21] V. Tanzi, *Social Protection in a Globalizing World*, Conference on “Managing the Future through Pension Schemes”, University “Tor Vergata”, Rome, 22-23 April 2004, p. 26.

[22] *KPMG's Corporate and Indirect Tax Rate Survey 2009*, p.4, www.kpmg.org.

[23] V. Tanzi, *Social Protection in a Globalizing World*, Invited Policy Paper, Conference on “Managing the Future through Pension Schemes”, University “Tor Vergata”, Rome 22-23 April 2004, p. 27.

costs to a minimum. A regulatory environment that emphasises competition will make it easier for resources to shift out of struggling industries into more profitable ones. Flexible labour markets make it easier for people to move into new jobs while supportive welfare policies can smooth the transition from inactivity to employment. For most Western European economies, globalisation is more of an opportunity than a threat. However, Southern and Eastern Europe are more exposed to it because they are competing for similar business with the fast-growing emerging nations. Countries differ widely in their ability to cope with the forces of globalisation, and in general the countries that are most exposed to these forces are also the ones that have less inherent strength to deal with them. Structural reforms would help them stay on a converging path despite the competition they face from the developing world.

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TRENDY W POLITYCE PODATKOWEJ NA ŚWIECIE

Streszczenie: W artykule podjęto próbę określenia stopnia oddziaływania globalizacji oraz harmonizacji na kształt współczesnych systemów podatkowych. Obu procesom przypisuje się szczególne znacznie na gruncie polityki społeczno-gospodarczej upatrując w nich właściwą drogę do osiągnięcia dobrobytu gospodarczego i społecznego kraju. Jednakże harmonizacja i globalizacja mają również swe negatywne strony. Mobilność czynników produkcji, kapitału i osób fizycznych oraz dynamiczny rozwój technologii wymuszają zmianę dotychczasowej pozycji fiskalnej państwa, która musi obecnie uwzględniać nowe determinanty, takie jak chociażby konkurencja podatkowa, będąca swoistym wyścigiem w obniżaniu ciężarów fiskalnych. Z drugiej strony mamy do czynienia z pogłębiającym się procesem harmonizacji (czego przykład stanowi Unia Europejska), który w wielu obszarach polityki fiskalnej ogranicza zakres autonomii fiskalnej państw członkowskich osłabiając tym samym ich pozycję w zglobalizowanym świecie.