

## PROMOTING A GLOBAL TAX ENVIRONMENT FOR GOVERNMENT AND BUSINESS

Today's global economy is characterised by integrated capital markets, innovative financial products, multinational enterprises which operate on a truly global basis, increased cross-border consumption and a dominance of services over the traditional manufacturing sector. These characteristics present opportunities for business and challenges to tax systems which were designed in a very different environment.

This more open environment encourages governments to constantly examine and adjust their tax systems so as to maintain their competitiveness and to remove tax obstacles to cross-border trade and investment. Such obstacles can take many forms: double taxation; lack of agreed international "tax rules"; inconsistency in the application of existing rules; anti-competitive tax practices; or lack of effective mechanisms for resolving tax disputes between two or more tax authorities.

In addition to the ever-increasing pressure to provide a favourable tax climate, governments must adjust their tax systems and enforcement capabilities to ensure that illicit tax activities do not proliferate as a result of the more open financial system. Tax authorities are finding it increasingly difficult to counter cross-border tax cheating, particularly when it involves financial centres where secrecy and anonymity are the rule.

Meeting these challenges in an environment of rapidly changing business models is not easy for governments, particularly when a premium is placed on minimising the compliance costs of taxation. The OECD is helping governments, both within and outside the OECD area, to meet these challenges.

### *Encouraging growth-promoting tax reform*

Governments recognise the need to review and reform their tax systems in response to an array of challenges, which include maintaining their international competitiveness, stimulating innovation and entrepreneurship, improving work incentives, and the consequences of ageing populations for financing pensions and healthcare. The OECD helps governments in this task by providing a forum where countries can exchange experiences and collectively analyse significant tax policy issues. A recent example is the OECD's work on employee stock options, which has involved an analysis of tax treaty aspects, transfer pricing implications and the incentives provided by domestic tax treatment. A longer-standing subject of study has been the effect of taxation on work incentives, which played an important role in the development of the OECD Jobs Strategy and continues to be a major concern of governments.

### **Removing tax obstacles**

Cross-border trade and investment would be seriously impeded if trade and investment flows were taxed twice, once in the source country and again in the country of residence. The OECD Model Tax Convention and the worldwide network of tax treaties based on it help to avoid the danger of double taxation by providing clear consensual rules for taxing income and capital. The Convention requires constant review to address new tax issues arising from a changing business environment. Recent updates have clarified the application of tax treaties to e-commerce transactions and stock options.

The Convention also covers commercial and financial transactions between different parts of a multinational group. Transfer pricing – the price charged for goods, services or intangibles between one part of a multinational enterprise and another – may diverge from market prices for a number of reasons, including tax planning. The “arms-length principle” set out in the Convention, and expanded in the OECD 1995 Transfer Pricing Guidelines, seeks to ensure that transfer pricing within the group is in line with pricing between independent firms so that the tax base is allocated fairly between the countries in which the multinational enterprise operates. Work is currently focused on monitoring the application of this principle to ensure a more consistent application and providing more practical guidance on the application of that principle to financial institutions and modern business operations.

### **Dispute resolution**

As global trade and investment increase, so does the risk of cross-border tax disputes. Left unresolved, these disputes can result in double taxation and an uncertain business environment which could impede the free flow of goods and services. Both governments and business need effective procedures to keep such disputes to a minimum and to resolve them satisfactorily when they do arise.

The OECD has helped establish guidelines for so-called “Advance Pricing Agreements (APAs)” in which governments and taxpayers can agree in advance the appropriate approach to determine the “arm’s length” price to be charged in transactions between related entities. These agreements create an assurance in advance for taxpayers that tax authorities will take a consistent approach to a cross-border transaction.

Nevertheless disputes will arise. The mutual agreement procedure (MAP) provided for in tax treaties is the traditional mechanism to resolve these disputes. The MAP has worked reasonably well in the past, but the number of cross-border disputes as well as the complexity of the cases involved has increased. Improving the effectiveness of the operation of the MAP and, equally important, ensuring that the cases involved will come to a timely and satisfactory conclusion, is the focus of an important new project at the OECD, which is also examining a number of supplementary techniques, including arbitration.

### **Tax co-operation**

Exchange of information is the key to better international tax co-operation, which is needed if OECD and non-OECD countries alike are to maintain effective sovereignty over the design of their tax systems and if the tax burden is to be shared fairly between citizens.

The OECD has been at the forefront of global efforts to combat international tax cheating. Over the past five years this work has delivered:

- A standard for access to bank information by tax authorities in OECD member states.
- A Model Agreement for Exchange of Information for Tax Purposes, which is being used as the basis for tax information exchange agreements between OECD countries and offshore financial centres.
- Commitments from 33 offshore financial centres to improve the transparency of their tax and regulatory regimes, and to establish effective exchange of information for tax purposes with OECD countries.
- A process of co-operation with non-OECD economies, including major competing financial centres, in a joint effort to ensure that these standards are applied at a global level.

Over the coming months efforts will be made to improve the process for achieving a “level playing field” in this area, thereby facilitating the negotiation of bilateral agreements which are the key to effective implementation of these commitments. The OECD welcomes the substantial progress that has already been made by some of its participating partners, and encourages the five uncooperative tax havens (Andorra, Lichtenstein, Liberia, Monaco and the Marshall Islands) to enter into this dialogue.

### **Promoting fair tax competition**

The OECD works to promote competition in trade and other areas, including taxation. However, just as there can be fair and unfair trade practices, there can also be tax practices that are anti-competitive and which undercut the potential gains of fair tax competition and undermine public confidence in the fairness of their tax systems. The OECD’s project on Harmful Tax Practices provides a framework for countries to work together to eliminate such practices with respect to financial and other services. In doing so, the OECD seeks to encourage an environment in which free and fair tax competition can take place.

The OECD identified 47 potentially harmful tax regimes within the OECD area in 2000. The result of three years of intense review was published in March 2004: 18 regimes have been abolished; 14 regimes have been amended to remove the harmful features; 13 have been found not to be harmful. Two regimes require further analysis before determinations can be made. The OECD will carry on monitoring the continuing and newly introduced preferential tax regimes that member countries think raise concerns under the preferential regime criteria set out in the 1998 report on Harmful Tax Competition and the progress reports issued in 2000, 2001 and 2004.

### **Influencing tax compliance**

Effective tax administration is not about collecting every last dollar payable under the tax laws. Rather, it is about optimising the overall level of voluntary compliance in a way that demonstrates the system is operating effectively. Increasingly across OECD countries, this has to be accomplished with diminishing budgets.

Better compliance has traditionally emphasised tax audits. However, audits are expensive and, from the perspective of many taxpayers, intrusive. Furthermore, except for the very largest taxpayers, tax administrations are not sufficiently resourced to enable broad, substantial audit coverage of taxpayers.

This is why governments have put a new emphasis on voluntary compliance. All tax administrations have a responsibility to properly educate taxpayers on their rights and obligations and to provide adequate standards of service that will facilitate taxpayers' voluntary compliance while minimising compliance costs. Research in OECD countries has demonstrated that targeted education and service strategies can be effective in helping to address significant non-compliance issues, provided they are combined with an effective enforcement strategy.

As a consequence of all these and other factors, tax administrations today face vastly increased demands that necessitate a more systematic approach to identifying key compliance risk areas. To achieve optimal outcomes, tax administrators must develop strategies tailored to each of the major compliance risks identified for each segment of taxpayers, recognising that non-compliance behaviour and attitudes vary substantially. Governments must also increase the awareness of corporate boards of the reputation and financial risks associated with their chosen tax strategies. These represent some of the most significant challenges to the successful administration of tax laws which are currently being examined by the OECD.

### **Developing partnerships**

The association of countries outside the OECD in the dialogue on key international issues is of critical importance for developing countries and for promoting global tax standards and good practices. The OECD's global tax programme of more than 60 events a year is focused on bringing non-OECD economies into the wider debate and helping countries to achieve sustainable development through a predictable tax base and enhanced ability to attract foreign direct investment.