# ‘Tax Reform: An International Perspective”

**The President’s Advisory Panel on Federal Tax Reform**

**San Francisco**

**31 March 2005**


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Good morning.  It is a pleasure and an honor for a representative of the OECD to appear before this Panel.

The OECD's main functions are to encourage countries to share their experiences, develop best practices and set international standards.  It also provides comparative information.  Drawing upon the experience of our 30 Member countries (**see Slide 2**) I will describe briefly the main characteristics of the tax reforms that have swept through the OECD area since the mid-1980's.  I will also present some statistical comparisons showing how the U.S. tax system compares to that of other countries.

Slide 3 identifies the main objectives that have driven the tax reform agenda.  Governments want fairer tax systems and systems which are overall progressive.  Fairness is a complex issue:  how do you decide when taxpayers are in similar circumstances?  How do you take account of non-compliance?  Yet, despite these difficulties, fairness is a key concept in the design of any tax system since perceptions of fairness influence taxpayers' attitudes towards compliance.

Reforms have also been motivated by the need to provide a competitive fiscal environment:  one which encourages risk taking, investment and provides the right work incentives.  Governments recognize that in today's global environment, capital and highly skilled labor are more prepared to relocate in response to tax differentials, although tax is only one of the many factors which influence location decisions.

Governments are also motivated by the desire to achieve a simpler tax system.  No one contests the need for greater simplicity:  the question is how to achieve it in a complex economic environment?   And how to achieve it without jeopardizing the fairness of the system.  Achieving simpler tax systems will, however, require that governments exercise more restraints in what they ask the tax system to achieve.

Within Europe, reforms have also tried to promote a cleaner environment.  Green tax reforms can achieve a better environment and a more diversified tax base.

What have OECD governments done to achieve these goals?  (See Slide 4)  Most importantly, they have cut the corporate and personal income tax rates, sometimes even halving them and, at the same time, they have broadened income tax bases by eliminating loopholes, special provisions and targeted reliefs.  A low rate, broad based income tax is not only simpler; it is fairer and produces less tax induced distortions.

Another characteristic of reform is the move towards flatter personal income taxes. This has been achieved by reducing the number of income tax brackets and today, most OECD countries have four or less brackets. Slovakia, in fact, has only two, a zero rate and a single positive rate. Flatter rate schedules do not necessarily mean less progressivity since this also depends upon how the tax base is defined and on the effectiveness of compliance measures.

Our Nordic countries have developed a dual personal income tax approach, under which wages are taxed at a progressive rate and dividends, interest and other non wage income are taxed at a single and generally lower rate, recognizing that capital is generally more mobile than labor.

The attractions of such an approach are that they simplify the taxation of wage income and provide fewer incentives for evasion of taxes on capital income, although they can encourage individuals to incorporate.

Another trend among OECD countries is the move to integrate direct tax and benefit systems (primarily by means of refundable tax credits) largely, but not exclusively, to encourage lower income groups to enter the labor force. Such measures can, however, increase the complexity of the tax system and illustrate the trade-off between simplicity and fairness.

As regards the taxation of dividends, the general tendency has been to provide more generous relief either at the corporate level or by providing relief for dividends under the personal income tax. **Slide 5** provides more details. In most OECD countries, the effective tax rate on distributed profits has fallen since 2000, thereby encouraging companies to distribute, rather than retain their profits.

Another structural change is the increased reliance on consumption taxes, although all OECD countries continue to have a mix of income and consumption taxes.

As regards complexity, this is an issue to which I will return in a moment.

Politicians have pursued green tax reform by introducing a whole range of environmental taxes and levies and tradable permits, although it is fair to say that in most countries, these are not significant revenue raisers.

A final comment on the characteristics of tax reform is that reform has become an ongoing process. Tax systems require continual adjustment to reflect changing economic and social circumstances.

Slide 6 shows the overall tax burden. Sweden has the highest tax to GDP ratio (50%) and the U.S. the second lowest at 25%. The slide also shows the relative importance of the different taxes. 90% of total tax revenues come from income taxes, social security contributions and consumption taxes. The U.S. stands out as a country that has a relatively higher reliance on income taxes and a relatively lower reliance on consumption taxes.

Slide 7 raises the interesting issue of how did the U.S. "buck the trend" in other developed OECD countries, which saw significant increases in tax to GDP ratios over the last 30 years. This may reflect inter-state competition, the lack of a robust consumption tax, choices on how to finance social welfare, education and retirement and attitudes towards the role of government.

Much of the tax reform debate is focused on the top schedule personal and corporate tax rates. (See Slide 8) This slide shows that personal income tax rates range from a high of 60% in Denmark to a low of 19% in Slovakia (the U.S. at 40% is just below the OECD average). Corporate income taxes range from a high of 45% in Japan to a low of 12.5% in Ireland. The U.S. had the second highest rate, although as can be seen from the Annex, the U.S. raises less than 8% of its total tax revenues from corporations, in part because the high schedule rate is offset by generous tax relief.

Slide 9 illustrates the tax wedge on labor. If we look at Belgium, what we see is that a firm which takes on a new employee will end up by paying more than 50% of its labor costs (wages plus employer's social security) to government in the form of personal income tax and social security contributions. The U.S. tax wedge is almost half that of Belgium.

VAT has swept through the tax world with 29 of the 30 OECD countries now having VAT (136 countries worldwide). (See Slide 10) The standard rate of VAT varies from 5% in Japan to 25% in Denmark. On average, OECD countries get almost 19% of their total revenues from VAT. Sales taxes in the U.S. account for 8%. VAT has proved to be a buoyant source of tax revenues for governments and most have been able to deal with the perceived regressivity of the tax by means of multiple rate schedules (lower rates being applied to basic necessities such as food and clothing) or by using the revenues generated by the VAT to provide social benefits to the lower income groups.

Slide 11 focuses on tax administration which tends to be the Cinderella of tax reform. Yet, administration feasibility should be an integrated feature of any reform program.

Tax administrations face increasing difficulties. Tax shelters abound, more taxpayers have easier access to tax havens. General attitudes towards compliance are declining. Tax administrations have difficulty in keeping pace with changing business models. Increasing demands are being placed upon tax administrations to provide resource intensive services to taxpayers and to manage compliance.

Tax administrations have responded by using new technologies to improve taxpayer service and enforcement, including targeting tax shelters. Good service **plus** enforcement are required to achieve good compliance. Nevertheless, many Commissioners are now finding that this is not enough and are trying to put tax compliance onto the good corporate governance agenda, thereby encouraging Boards of Directors to be more aware of the financial and reputational risks associated with any tax strategy.

Slide 12 pulls together some of the lessons that our member countries have learned on what it takes to have a successful tax reform process. Not all of these factors may apply in the U.S., but many will.

Conclusions

Three concluding comments:

1. Fundamental tax reform will always require trade-offs between competing objectives. Economic analysis has an important role to play in making these judgments but it should be informed by the experience of other countries.

2. My presentation has provided you with a very broad overview of these experiences. The annex to my slides provides more information.

3. OECD stands ready to provide additional comparative information on the tax reform experiences of OECD countries.

Thank you for the opportunity provided to the OECD to share our experiences with you today.