OECD's Current Tax Agenda

APRIL 2011

ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT

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CORE ISSUES

Tax Reforms to Improve Economic Performance

In the wake of the recent financial and economic crisis, all countries face the challenge of restoring public finances without jeopardising economic growth. How can tax structures best be designed to support GDP per capita growth?

Growth-oriented tax systems seek not only to minimise the distortions by the tax system, but also to create as few obstacles as possible to investment, innovation, entrepreneurship and other drivers of economic growth. Recent OECD empirical analysis suggests a "tax and economic growth" ranking order according to which corporate income taxes are the most harmful type of tax for economic growth, followed by personal income taxes and then consumption taxes, with recurrent taxes on immovable property being the least harmful. This reflects the different distortionary effects of different taxes. A growth-oriented tax reform would, therefore, shift part of the tax burden from income to consumption and/or residential property, as well as taxes that correct environmental and other externalities.

A move towards a "green" tax system, crucial to a "green growth" strategy, can contribute not only towards achieving environmental objectives but also, depending on how the revenues are used, facilitate wider growth-oriented tax reforms. Extra tax revenues from efforts to strengthen compliance, such as the OECD initiatives to counter offshore non-compliance, may also contribute to reducing tax distortions by ensuring that all citizens pay their fair share of taxes.

Within individual main tax categories – property, consumption, personal and corporate income tax – there is scope for making the design more conducive to economic growth by levying these taxes on a broader base, possibly at a lower rate, rather than providing targeted relief for particular activities and purposes. However, this does not mean that it is optimal to abolish all targeted tax reliefs.

There are good economic reasons for targeted tax reliefs that correct market failures or contribute to redistributing income. Tax concessions are sometimes also introduced to favour a particular interest group or to reduce compliance and administrative costs. Even when tax reliefs have well-founded redistribution and economic policy objectives, they entail a loss of government revenues, which necessarily means that other taxes have to be higher than they otherwise would be (and/or government expenditure has to be reduced). These higher rates may create additional efficiency losses and have adverse effects on income distribution and on administrative and compliance costs.

Governments need to assess preferential tax treatments periodically to evaluate whether their benefits actually outweigh their costs. Despite a trend over the last 30 years towards broader tax bases, targeted tax provisions continue to be significant in many countries. Maintaining a broad base can be a challenge and in some countries (*e.g.* the United Kingdom and the United States) which had significant base broadening tax reforms in the mid-eighties, special regimes have crept back in. Tax reliefs in the form of exemptions from tax, reductions of tax liability (deductions and credits) or tax rates that are lower than the standard rate (and which are not a structural feature of the tax regime) are often called "tax expenditures", because they can be seen as equivalent to public expenditure implemented through the tax system. While there is controversy around the definition and measure of tax expenditures, the estimates of their revenue costs can provide a useful starting point for their evaluation. Tax expenditure data suggest that the major tax expenditures relate to provisions for owner-occupied housing, retirement savings, small businesses, R&D expenditures and reduced VAT rates for food.

Economic analysis suggests that a number of tax provisions do not constitute a cost-effective way of achieving either fairness or efficiency objectives. In particular, VAT-preferential treatments (including rate differentiation) are generally not well targeted to those in need, distort consumer choice, and impose additional administrative and compliance costs (*e.g.*, the need of drawing borderlines between standard and reduced rate goods and services).

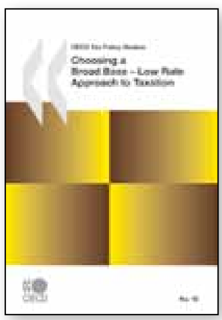
Growth-enhancing tax policies also include levying the corporate tax on a broader base and with a lower rate, and specific taxes to correct externalities (*e.g.* taxes related to greenhouse gas emissions). However, some degree of support for research and development through the tax system may also help to increase private spending towards the socially desirable level of innovation.

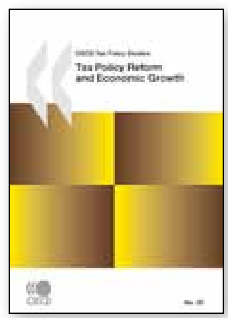
In the case of personal income taxation, the economic arguments for base-broadening can be less clear-cut. Tax reliefs may reflect not only "ability to pay" concerns, but also economic efficiency arguments that may, for instance, point to lower rates of taxation on capital than on income from labour. However there is also evidence that wealthier individuals are benefiting the most from the tax preferential treatment of savings and that these reliefs have changed the composition of savings rather than increased total private savings. Other growth-enhancing tax policy options include a reduction in the top marginal personal income tax rates, if these rates have a strong negative impact on human capital formation and entrepreneurship, and well-designed incentives to work at low earnings.

In addition to increasing government accountability and transparency of tax policy decisions, economic analysis of targeted tax reliefs may help identify possible candidates for base-broadening tax reform. The final decision on whether to eliminate or reduce such reliefs is, of course, a political one. Economic analysis and a strong economic case, while not guaranteeing success, may help to obtain the political support as well as the support from the civil society needed for a particular base-broadening reform.

Key Publications

- OECD (2010), *Choosing a Broad Base – Low Rate Approach to Taxation*, OECD Tax Policy Studies No. 19, OECD Publishing, Paris.
- OECD (2010), *Tax Policy Reform and Economic Growth*, OECD Tax Policy Studies No. 20., OECD Publishing, Paris.





Tax Policy Analysis and Statistics

CORE ISSUES

Tax Policy Analysis

The past two decades have been characterised by on-going tax reforms, with governments restructuring their tax systems to achieve their social and economic objectives and, at the same time, secure the revenues required to finance their expenditures. The OECD helps countries in this process by undertaking tax policy analysis from an international comparative perspective, and thereby assisting policy makers in designing tax policies that are suited to their objectives. The OECD's work in this area uses a combination of economic theory and evidence, both statistical and case study materials, to provide an account of likely intended and unintended effects of alternative tax policies.

Stephen Matthews speaking at the Brussels Tax Forum, "Tax Policies for a Post-Crisis World", 1-2 March 2010

These effects are evaluated in terms of their impact on economic efficiency, income distribution, economic growth and other policy objectives.

Taxation and Economic Growth

Much of the OECD tax work involves working across a number of areas where tax is an important issue. A good example is Taxation and Economic Growth – a project which investigated the design of tax structures to promote economic growth. Corporate taxes were found to be most harmful for growth, followed by personal income taxes, and then consumption and environmental taxes. Recurrent taxes on immovable property appear to have the least adverse impact on growth.

"The aftermath of the financial crisis and recession for budget deficits and public debt means that many OECD countries are likely to have to make discretionary increases in taxation as the recovery strengthens to maintain sound public finances. Analysis and discussion of the economic and distributional effects of the balance of taxation between different taxes and the respective merits of raising revenues by broadening tax bases and raising rates will be at the heart of the work programme of the Working Party on Tax Policy and Statistics in coming years."

Mr. Stephen Matthews
Head of Tax Policy and Statistics Division, Centre for Tax Policy and Administration

In the wake of the recent financial and economic crisis, many countries face the challenge of restoring public finances. So how can countries best raise taxes without jeopardizing economic growth? A growth-oriented tax reform would reduce distortions in current tax regimes and to raise additional revenues from the taxes that do the least damage to prospects of economic growth as consumption and environmental taxes and recurrent taxes on immovable property. Meanwhile, it must be recognized that practical tax reform must achieve a balance between efficiency, equity, simplicity and revenue concerns.

For more information, see the *Hot Topic: Tax Reforms to Improve Economic Performance*.

Tax and the Environment

Tax policies can also contribute to address climate change and other environmental challenges. The OECD's Green Growth Strategy is helping member countries reform public policies in ways that can make environmental concerns and economic growth go hand in hand. Environmentally related taxes and tradable permits are essential, because adequately pricing pollution is vital for encouraging businesses and consumers to adopt environmentally-friendly practices and spur innovation.

One of the first major publications of the Green Growth Strategy was Taxation Innovation and the Environment has now been released. Through a number of case studies across countries, it sheds light on how the links between environmentally related taxes and innovation works in practice. Are taxes effective in bringing about green innovation? Does the design of environmental taxes matter? And how should tax instruments be combined

"Fair taxation is essential for repairing public finances and building a stronger post-crisis economy. TUAC welcomes the OECD's ground-breaking work and urges it to drive this agenda forward so as to deliver tax systems that put working people first, promote green jobs, clamp down on tax evasion and international tax arbitrage, and strengthen the tax base of developing countries."

Mr. John Evans
General Secretary, TUAC

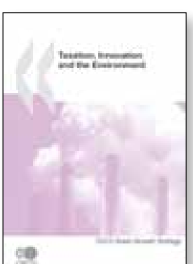
with other environmental and R&D policies to best nurture environmentally friendly innovation? For more information see the *Hot Topic: Green Growth and Climate Change: Taxation and Tradable Permits*.

The OECD, working with business and government, is also examining how to remove the obstacles to a broader use of tradable permits.

Tax policies can also be harmful to the environment. G20 heads called upon the OECD, OPEC, IEA and the World Bank to look at subsidies to fossil fuels and provide guidance in phasing them out. In many OECD countries, these subsidies take the form of tax expenditures, either towards the production of fossil fuels or to their consumption. Work is underway to identify and quantify such tax expenditures.

Previous work has looked at obstacles to the full use of environmentally related taxes, including the impact on low-income households and concerns about the international competitiveness of energy intensive industries. The 2006 publication *The Political Economy of Environmentally Related Taxes* examined the effects of introducing environmentally related taxes on heavily polluting industries, as well as the effects of possible approaches to mitigate international competitiveness pressures. The report also analysed case studies of countries that have successfully introduced environmentally related taxes on business, including how competitiveness concerns were overcome.

Taxation and Innovation Policy



The OECD Innovation Strategy is a multidisciplinary, multistakeholder project that aims to help governments boost innovation, in order to promote sustainable growth and to address global challenges.

The key drivers of innovation that are affected by the tax system have been identified, along with the main tax policy considerations that might have an impact on R&D spending and innovative activities, the dissemination of knowledge, tax planning with the use of intangible assets, as well as the conceptual frameworks that can be applied to build tax indicators and assess the effectiveness of government actions. Other tax and innovation topics that were discussed are the greening of the economy, business creation and risk-taking, education and the mobility of high-skilled workers.

Taxation and the Distribution of Income

Governments recognise that the tax system has an important role to play in reducing inequalities in the distribution of income and wealth. In a number of

OECD countries top incomes have grown much faster in the past couple of decades than incomes at lower percentile points in the distribution. A joint study with Directorate for Employment, Labour and Social Affairs will look at the impact of globalisation on the distribution of income, analysing trends in top incomes and the potential implications for tax policy.

Tax Statistics

To support analytical work and inform both governments and the wider public, CTPA collects a wide range of information on tax revenues and tax systems in its member countries. The work on tax statistics provides policy makers and business with high quality international comparative data on the levels and structures of taxes in OECD countries. This complements the work on tax policy analysis, by providing regular quantitative comparisons of tax systems across OECD countries. The main outputs are two annual publications.

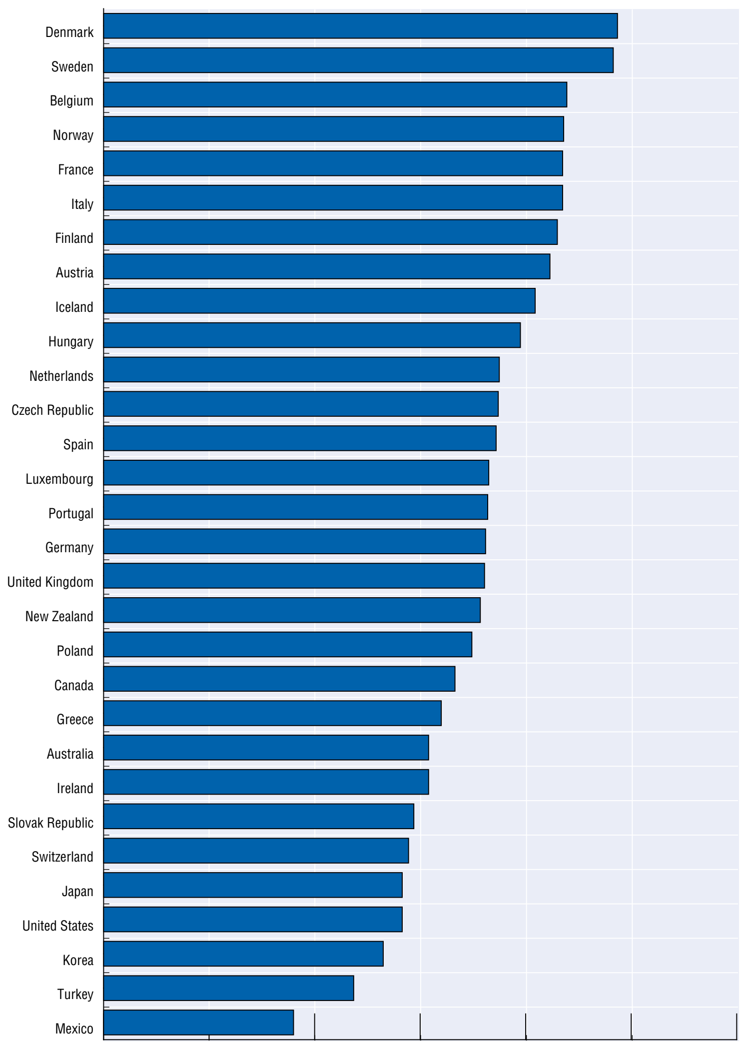
Revenue Statistics presents a unique set of detailed and internationally comparable tax revenue data in a common format for all OECD countries from 1965 onwards. It also provides a conceptual framework defining which government receipts should be regarded as taxes and classifies different types of taxes. The 2010 edition was published on 15 December 2010, with a special feature on environmentally-related taxation. This publication reports tax revenues for each OECD country, providing a very detailed breakdown by type of tax. This allows a comparison of tax levels between countries (see Figure 1) and within countries across levels of government. It also enables an analysis of the differences in tax structure in OECD economies.

The OECD Revenue Statistics builds on a very long tradition, but it is constantly refined to address emerging trends in government finances. One question currently being discussed relates to global climate change: should revenue from the allocation of tradable permits for CO2 emissions be considered equivalent to taxes in international revenue statistics? Another relates to whether payments made by banks and other credit institutions to insure deposits made by customers should be classified as tax revenues.

Taxing Wages provides unique information on income tax paid by workers and social security contributions levied on employees and their employers in OECD countries. In addition, it describes those family benefits that are paid as cash transfers. Amounts of taxes and benefits are detailed programme by programme, for eight household types which differ by income level and household composition.

This annual publication provides information on how personal income taxes, social security contributions, payroll taxes and universal cash benefits combine together to affect the disposable income of the different "typical" households. It provides figures on average tax rates (see Figure 2) and marginal effective tax rates that apply to additional earnings. These provide insights into the effects of direct tax systems on incentives for employment and increasing hours of work, and on the distribution of disposable income between different types of household. The 2009 version was published in May 2010, with a special feature on non-tax compulsory payments. The next version will be published in May 2011, with a special feature on Wage Income Tax Reforms and Changes in Tax Burdens: 2000-09. This special feature calculates the changes in the tax burden on wage income ranging from 50% to 250% of the average

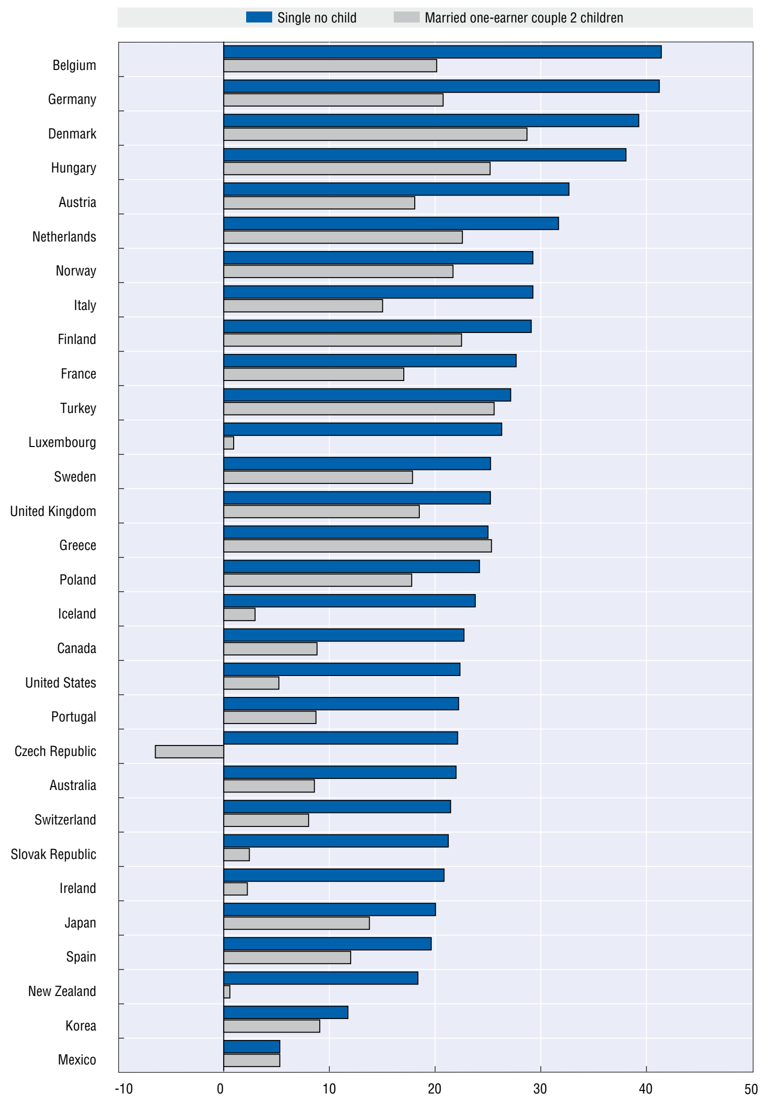
Figure 1. **Total tax revenue as percentage of GDP, 2008**



Source: OECD (2010), Chart A. Total tax revenue as percentage of GDP, 2008, in *Revenue Statistics*, OECD Publishing, Paris.

wage by comparing the tax burden in 2000 and 2009 and calculates the respective contributions of changes in income taxes, employee social security contributions, employer social security contributions and cash benefits.

Figure 2. **Income tax plus employee contributions less cash benefits, by family type (as % of gross wage earnings), 2009**[1]



1. Countries ranked by decreasing tax burden.

Source: OECD (2010), Graph I.3. Income tax plus employee contributions less cash benefits: By family-type, as % of gross wage earnings, 2009, in *Taxing Wages 2009*, OECD Publishing, Paris.

Tax Policy Activities with Non-OECD Economies

For several years, tax policy activities with non-OECD economies have focused on tax-modelling workshops. However, the range of activities has now expanded to include workshops on tax incentives and on a selection of tax policy issues.

The aim of these workshops is to share the experiences that OECD countries have accumulated of using various tax policies, as well as methods that have been developed to analyse and predict their likely impacts. For more information, please see Developing a Global Partnership.

Regional Programmes on Tax Policy Analysis

The Tax Policy and Statistics Division of the CTPA currently manages three regional tax programmes – one in the Middle East North Africa (MENA) region, another in South East Europe (SEE) – and a recently launched fiscal initiative for the Latin American and Caribbean countries (LAC). These programmes aim to encourage regional dialogue among senior tax policy officials; and strengthen capacity for tax policy analysis, to help inform policy decision-making. The OECD offers support both by sharing information, data, analyses and experiences of OECD country tax officials, reported in the OECD Tax Policy Studies series, and by organising workshops to help officials implement standard 'tax models' to assess cross-country differences in effective tax rates on labour and capital income, and to estimate changes in and redistribution of tax liability (tax burden) resulting tax reform.

At the fifth meeting of Working Group 3 (Tax Policy Analysis and Tax Administration) of the MENA-OECD Investment Programme, held 1-2 June 2010 in Manama , Bahrain, participants discussed the use of VAT as a potential revenue source funding economic development in the MENA region, including Gulf Co-operation Council (GCC) countries. Over 60 senior policy officials from thirteen MENA countries attended the meeting. Key issues discussed included implications of VAT on income distribution and how best to address possible regressive effects of a broad VAT base, limited experience with tax administration in certain countries, and scope for cross-border shopping and carousel fraud. Further work was required to assess the potential yield and implications for tax administrations in MENA countries currently without a VAT.

The third meeting of the South East Europe Working Group on Tax Policy Analysis held 10-11 June 2010 in Sofia, was hosted by the National Revenue Agency of the Bulgarian Ministry of Finance. The following topics were addressed: taxation, innovation and training; the tax chapter of the OECD publication, *Investment Reform Index 2010 – Monitoring Policies and Institutions for Direct Investment in South East Europe*; SEE and EU country tax responses to the global financial crisis; implementing pro-growth tax reforms; and combating tax fraud in South East Europe.

Questionnaires were reviewed on taxation and innovation, and taxation and training, with the aim of gathering questionnaire replies to enable the drafting of a comparative report, to be considered at the next meeting of the working group to take place in early 2011.

A first meeting of the *LAC Tax Policy Forum* was held 16-17 September 2010, in Panama City. The organisation of this meeting by the OECD, together with the Inter-American Centre of Tax Administration (CIAT) and the Ministry of Economy and Finance of Panama (as host), was an important milestone under the fiscal component of the LAC (Latin America and Caribbean)-OECD Initiative.

Over 60 tax officials participated in the meeting, from 14 Latin American and Caribbean countries. Representatives of various national and international organisations also participated (including CIAT, ECLAC, IADB, IFS of Spain, IMF, USAID, Getulio Vargas Foundation of Brazil, ICEFI of Guatemala, ADETEF of France).

This meeting provided an opportunity to explain to senior tax officials of LAC countries the purpose of the *LAC Tax Policy Forum*, namely to: provide a forum for senior tax officials of LAC countries to critically assess key tax policy issues in the region, by sharing data, analytical tools, analysis and experience; assist with the design of reform measures to improve tax systems and fiscal consolidation in LAC countries; and address expenditure policy and involve fiscal policy officials depending on agenda topics to be decided by participants of the Forum (*e.g.* in addressing fiscal consolidation).

Inaugural LAC Tax Policy Forum 16-17 September 2010, Panama City, *from left to right* Mr. Dayton-Johnson (OECD), Mr. Verdi (CIAT), Mr. Vallarino (Minister of Finance, Panama), Ms. Pérez-Navarro (OECD), Mr. López López-Ríos (Spanish Embassy to Panama), and Mr. Cucalón (MEF Panama)

The main topic addressed at the meeting was the role of the tax system in reducing income inequality and promoting social cohesion. Participants also reviewed data reported in the *Latin America Revenue Statistics* database and publication, used to support policy dialogue.

For more information, see LAC-OECD Fiscal Initiative: www.oecd/tax/lacfiscal.

Topics that have been addressed by CTPA in Tax Policy Studies include:

- Choosing a Broad Base- Low Rate Approach to Taxation
  - Tax Policy Reform and Economic Growth
  - Tax and SME Creation, Growth and Compliance Costs
- Tax Effects on Foreign Direct Investment: Recent Evidence and Policy Analysis
- Fundamental Reform of Corporate Income Tax
- Encouraging Savings Through Tax-preferred Accounts
- Taxation of Capital Gains of Individuals: Policy Considerations and Approaches
- Fundamental Reform of Personal Income Tax
- Taxing Working Families: A Distributional Analysis
- The Taxation of Employee Stock Options
- E-Commerce: Transfer Pricing and Business Profits Taxation
- Recent Tax Policy Trends and Reforms in OECD countries
- Using Micro-Data to Assess Average Tax Rates
- Fiscal Design Survey across Levels of Government
- Tax and the Economy: A Comparative Assessment of OECD Countries

Key Events

- Bilateral Tax Policy Workshop, Yangzhou, China, 14-18 March 2011.
- Micro-simulation Analysis and Forecasting Workshop, Brazil, 6-10 June 2011.
- OECD 50th Anniversary Tax Reform Conference, Paris, 30 June 2011.
- Fourth Meeting of the South East Europe (SEE) Working Group on Tax Policy Analysis, September 2011.
- International Seminar on Environmental Taxation, Beijing, 26-27 October 2010.
- Expert Workshop on Estimating Support for Fossil Fuels, Paris, 18-19 November 2010.
- First meeting of the LAC Tax Policy Forum, Panama City, 16-17 September 2010.
- Fifth Meeting of Working Group 3 (Tax Policy Analysis and Tax Administration) of the MENA-OECD Investment Programme, Manama, Bahrain, 1-2 June 2010
- 3rd Meeting of the South East Europe Working Group on Tax Policy Analysis, Sofia, 10-11 June 2010.

Key Publications

- Taxation, Innovation and the Environment, October 2010
- Taxing Wages 2009: Special feature: Non-tax compulsory payments, May 2010
- Revenue Statistics 2010: Special feature: Environmentally-Related Taxation, December 2010.
- The Political Economy of Environmentally Related Taxes, June 2006

Tax Policy Analysis and Statistics on the Web

- *www.oecd.org/ctp/tpa*
- OECD Tax Database: *www.oecd.org/ctp/taxdatabase*
- MENA Initiative on Governance and Investment for Development: *www.oecd.org/mena*
- LAC-OECD Fiscal Initiative: *http://www.oecd.org/tax/lacfiscal*

Want to Know More?

Key Links

Consumption tax	*www.oecd.org/ctp/ct*
Dispute resolution	*www.oecd.org/ctp/dr*
Exchange of information	*www.oecd.org/ctp/eoi*
Harmful tax practices	*www.oecd.org/ctp/htp*
Global Forum on transparency and exchange of information for tax purposes	*www.oecd.org/tax/transparency*
OECD tax database	*www.oecd.org/ctp/taxdatabase*
Partnerships with non-OECD economies	*www.oecd.org/tax/globalrelations*
Tax administration	*www.oecd.org/ctp/ta*
Tax crimes and money laundering	*www.oecd.org/ctp/taxcrimes*
Tax evasion	*www.oecd.org/tax/evasion*
Tax policy analysis	*www.oecd.org/ctp/tpa*
Treaty Relief and Compliance Enhancement	*www.oecd.org/tax/trace*
Transfer pricing	*www.oecd.org/ctp/tp*
Tax treaties	*www.oecd.org/ctp/tt*
Tax treatment of bribes	*www.oecd.org/ctp/ttb*

Key Publications

- Revenue Statistics 1995-2009 (2010 edition)
- Taxation, Innovation and the Environment (2010)
- OECD Tax Policy Studies No.19: Choosing a Broad Base – Low Rate Approach to Taxation (2010)
- OECD Tax Policy Studies No. 20: Tax Policy Reform and Economic Growth (2010)
- Model Tax Convention on Income and Capital (2010)
- Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations (2010 update)

- Taxing Wages (2010)
- Consumption Tax Trends 2010: VAT/GST and Excise Rates, Trends and Administration Issues
- Tax Administration in OECD and Selected Non-OECD Countries: Comparative Information Series 2010
- Global Forum on Transparency and Exchange of Information for Tax Purposes, 18 Peer Review Reports

Key Events in 2011

- Tax and Crime: A Whole-of-Government Approach in Fighting Financial Crime, Oslo, 21-23 March 2011
- Second Plenary Meeting of the informal Task Force on Tax and Development, Paris, 11-12 April 2011
- 11th Annual U.S. & Europe Tax Planning Strategies Conference, Paris, 14-15 April 2011
- Global Forum on Transparency and Exchange of Information for Tax Purposes, Bermuda, 31 May – 1 June 2011
- OECD-USCIB Tax Conference, Washington, 6-7 June 2011
- High Level Seminar: Current Issues in Transfer Pricing – Delhi, India, 13-14 June 2011
- OECD 50th Anniversary: High Level Tax Reform Conference, Paris, 30 June 2011
- 16th Annual Tax Treaty Meeting, Paris, 15-16 September 2011
- First Annual Transfer Pricing Meeting, Paris, 3-4 November 2011
- Fifth ITD Global Conference on Inequality, 5-7 December 2011
- Seventh Forum on Tax Administration, Argentina, 18-19 January 2012

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