



ISSUES IN INTERNATIONAL TAXATION AND THE ROLE OF THE IMF

June 28, 2013

EXECUTIVE SUMMARY

In the discussion of the Board work program on June 3, 2013, it was urged that the Fund be more present in current discussions of international tax issues. This note reviews key issues and initiatives in this area, and sets out a work plan that is focused on the Fund's mandate and macroeconomic expertise and that complements the work of other institutions, notably the OECD.

The work plan is focused on macro-relevant cross-country spillovers from national tax design and practices. The issues of tax avoidance by multinationals and evasion by individuals that are the focus of immediate concerns and initiatives are important instances of such spillovers. But there are many others too, and issues would arise even in the absence of compliance problems: for instance, the current trend among advanced countries away from residence-based taxation of active business income arising abroad and toward territorial taxation can have powerful spillover effects, including for developing countries. The work plan will complement that of others by exploring under-studied aspects of this overarching spillover issue, and assessing the need for, and possible forms of response. The issues are sensitive and technically difficult, but the current debate points to a need to consider fundamentals of international tax design.

This work will exploit the comparative advantage that the Fund derives from its extensive analytical and technical expertise in the economics and practicalities of international taxation, and its near-universal membership. Staff have been at the forefront of the economic analysis of international taxation for many years, and the issues are routinely addressed in the Fund's technical assistance to a wide variety of countries. The Fund's wide experience and close engagement with many members on continuing programs of broader tax reform give it a unique experience base and perspective from which to contribute. Close cooperation with the OECD and others active in the area is planned; so too is extensive outreach.

Approved By
Carlo Cottarelli

Prepared by an FAD team led by Michael Keen and Victoria Perry

CONTENTS

ISSUES	3
A. Tax Avoidance by Multinationals	4
B. Tax Evasion by Individuals	6
C. Spillovers and Tax Competition	7
CURRENT GLOBAL INITIATIVES	8
A. Base Erosion and Profit Shifting (BEPS)	9
B. Information Exchange	9
THE ROLE OF THE IMF	10
A. Mandates and Comparative Advantage	10
B. Previous and Current Work	11
AREAS FOR FUTURE WORK	12
A. Paper on “Spillovers in International Taxation”	12
B. Inform and Contribute to Technical Discussions	15
C. Encourage and Contribute to the Wider Debate	15
QUESTIONS FOR DIRECTORS	16
BOXES	
1. International Tax Planning—Tricks of the Trade	5
2. IMF Technical Assistance in International Taxation	11
REFERENCES	17

This note sets out a work plan on international taxation that focuses on macro-relevant spillovers, exploits the Fund's comparative advantages, and complements the work of other institutions, notably the OECD. Section I outlines the substantive issues, and Section II describes current global initiatives. Section III sets out the Fund's mandate, comparative advantage, and previous work in the area. The work planned is described in Section IV.

ISSUES

1. International tax issues have risen to prominence in public debate and are now attracting considerable attention from policymakers. Most recently, the 'Lough Erne Declaration' from the G-8 summit of June 17–18, 2013 set out a number of commitments and objectives in this area, including for instance the aspirations that "Tax authorities around the world should automatically share information to fight the scourge of tax evasion" (point 1) and that "Countries should change rules that let companies shift their profits across borders to avoid taxes..." (point 2).¹

2. There are, broadly speaking, two sets of issues on which current actions are focused: (legal) tax avoidance² by multinationals, and (illegal) evasion by rich individuals. These do not cover all international tax problems, of course: multinationals might evade, for instance, and individuals can avoid—and these are in practice significant issues. This distinction is, nonetheless, a useful organizing framework for understanding current debates and initiatives. Subsections A and B below elaborate on them in turn.

3. The overarching problem, however, is in each case the fundamental difficulty that national tax policies create cross-country spillovers. The opportunities for avoidance and evasion that are now such a concern are a very visible manifestation of such spillovers: they exploit gaps and inconsistencies in the international tax framework that arise from combining national tax systems. But the setting of national tax policies without considering the spillovers on other countries can generate distortions even in the absence of erosion and evasion phenomena. These can arise instead in the less visible but perhaps even more damaging form of either a dislocation of economic activity purely to exploit differences in national tax policies or an overall

¹ Point 2 also provides that "...multinationals should report to tax authorities what tax they pay where. Other tax-related points provide that tax collectors should be able to see easily through to companies' owners (point 3) and that "Developing countries should have the information and capacity to collect the taxes owed them—and other countries have a duty to help them" (point 4).

² The term is used loosely, since the frontier of legality is not always clear, and whether an activity is 'avoidance' depends on the imponderables of legislative intent and the counterfactual of what arrangements would have been made absent tax considerations.

level of taxation below that which would be chosen if countries took full account of how each is affected by the others' policies. This point is developed further in Subsection C.³

A. Tax Avoidance by Multinationals

4. Tax avoidance by multinationals has emerged as a major risk to governments' much-needed revenue and, ultimately, citizens' trust in the tax system—not only in advanced but also in developing and emerging economies. Recent high profile cases of multinationals paying very small amounts of tax have caused considerable public disquiet in many advanced economies—and similar concerns have become increasingly apparent in many developing countries. At a time when taxpayers are being asked to shoulder heavier burdens, the concern is a reasonable one, on grounds of equity—much of the benefit is likely to go to the better off⁴—as well as efficiency—through the distortion of real activities, and need to raise revenue from potentially more distortionary means or cut valued public spending—and sustaining public support for the wider tax system.

5. It is widely recognized that the current framework for international taxation is under considerable strain, as the landmark report of the OECD (2013) makes clear. A century ago, when the basic principles were put in place, foreign direct investment was largely a bricks-and-mortar business. Developments since, however, mean that this framework has enabled extensive 'base erosion and profit shifting' (BEPS)—the artificial reduction of taxable profits and/or detachment of tax location from the location of business activity. Box 1 provides an overview of some common tax planning strategies. Key factors underlying these include the increased importance of:

- ***Intra-firm transactions and complex modern business models.*** Intra-firm flows, including the provision of intangibles, put increased strain on the notion of 'arms-length' prices—those which would be set in the same transaction between unrelated parties—as a way to allocate profits between jurisdictions. Moreover, while the current international tax framework has been constructed predominantly through bilateral arrangements, whose primary focus is on allocating taxing rights between the two countries concerned, business models are now so globally integrated that looking at any two locations in isolation is unlikely to be sufficient to arrive at an appropriate split of tax base.
- ***Digital transactions.*** The current international tax architecture took shape when a physical presence was presumed necessary to undertake business activity. But IT

³ While similar issues arise across sub-national governments when these have tax-setting powers, the focus will be on spillovers at country level.

⁴ This is not, however, as clear as it may seem, as some of the tax savings may be passed back to labor as higher wages, for reasons discussed in IMF (2009). Those same arguments imply that the more widely available are avoidance opportunities and the greater the extent to which they increase after-tax profits above the minimum that investors require rather than distort their behavior at the margin, the more likely it is that the benefits will remain with capital owners. There is little firm evidence on these issues.

advances now allow many more businesses to undertake substantial economic activity without the degree of physical nexus required to be subject to the corporate income tax; by, for instance, providing services over the internet.⁵

- **Financial sector innovation.** The current international tax framework makes distinctions between forms of income (business profit, investment income, capital gains, etc.) and between ‘active’ and ‘passive’ income that financial innovation has made quite easy to engineer around.
- **Intangibles.** The increased importance of intellectual property rights and other intangibles—easy to move and hard to value—has posed particular difficulties.

Box 1. International Tax Planning—Tricks of the Trade

While the precise design of tax planning schemes is driven by specific features of national tax systems, common strategies include:

- **Shifting profits to low tax jurisdictions**—abusive transfer pricing is often raised as a concern, but there are many other devices too: these include the direct provision of services from, and location of intellectual property rights in, low tax jurisdictions;
- **Taking deductions in high-tax countries...**—by, for example, borrowing there to lend to affiliates in low-tax jurisdictions;
- **...and as many times as possible**—passing on funds raised by loans through conduit companies may enable interest deductions to be taken several times (without offsetting tax on receipts);
- **Exploiting mismatches**—tax arbitrage opportunities can arise if different countries view the same entity, transaction, or financial instrument differently;
- **‘Treaty shopping’**—treaty networks can be exploited to route income so as to reduce taxes;
- **Delay repatriating earnings**—countries operating worldwide systems defer taxing business income earned abroad until it is paid to the parent.

A wide range of counter-measures are also deployed by tax authorities. ‘Controlled Foreign Corporation’ rules, for instance, enable them to bring into tax ‘passive’ income retained abroad; general anti-avoidance/abuse rules can be deployed; and ‘limitation of benefit’ provisions aim to limit treaty shopping. But these and other measures have not proved fully effective responses.

6. **Otherwise benign arrangements in some cases increase the risk of avoidance.** Tax treaties, in particular, while traditionally seen as important to facilitate investment flows, have in many cases enabled the host country’s tax base to leak elsewhere, including by ‘treaty shopping’. Some difficulties arise simply from mismatches in national practice and definitions (of, for example, where a company is resident and hence liable to tax).

⁵ Similar issues also arise in relation to the VAT and other consumption taxes.

7. The Fund’s technical assistance (TA) and other discussions have shown that many countries are increasingly concerned at the difficulty of taxing business activities within their jurisdiction. Especially where administrative capacity is weak, authorities increasingly fear that their base is being substantially eroded in ways that are less than fully understood—with adverse effects on the trust between authorities and large investors.

8. The extent of artificially shifted income is hard to assess, but there are signs that it is large. Beyond the anecdotes of high profile cases, the evidence of such effects (usefully reviewed in OECD, 2013) is essentially indirect—but suggests that the revenue at issue is substantial. One sign, for instance, is that positive shocks to parent companies’ earnings are followed by a larger increase in pre-tax profits of affiliates in low-tax countries than of those in high-tax countries (Dharmapala and Reidel, 2013). For the United States, Gravelle (2013) reports estimates of the annual revenue loss from profit shifting between \$10 and \$60 billion (the higher figure being about one-quarter of all receipts from the federal corporate income tax in 2012); and, a further indication of orders of magnitude, President Obama’s international tax proposals,⁶ relatively technical in nature, are projected to raise around \$15 billion per annum.

B. Tax Evasion by Individuals

9. Opportunities for tax evasion are increased when low-tax jurisdictions do not share taxpayer information with foreign tax authorities. In most countries, individuals are liable to tax in their home country on their worldwide income (with credit for any taxes paid abroad). This cannot be properly enforced, however, unless the home country can obtain information on assets or income located abroad.

10. Though the extent of the problem is again hard to assess, there are signs that it is substantial. The IRS probe of U.S. taxpayers with accounts in UBS, for instance, led to disclosure of 4,450 accounts (and a fine on UBS of \$780 million). More generally, one estimate is that around 6 percent of the global net financial wealth of households—about \$4.5 trillion—is unrecorded and located in tax havens (Zucman, 2013).⁷

11. Jurisdictions heavily reliant on these activities face risks. Inflating balance sheets by extracting funds escaping taxation or other legal requirements can create vulnerabilities; and, for some countries, international actions discouraging these activities, described below, may call for changes in wider development strategies.

12. Tax evasion—and avoidance too—benefit from secrecy provisions. Tax and criminal justice authorities’ difficulties in accessing information on the beneficial ownership of

⁶The President’s Framework for Business Tax Reform: A Joint Report by the White House and the Department of the Treasury, February 2012 at <http://www.treasury.gov/resource-center/tax-policy/Documents/The-Presidents-Framework-for-Business-Tax-Reform-02-22-2012.pdf>.

⁷ Estimated from an extended and updated version of the dataset constructed by Lane and Milesi-Ferretti (2007).

corporations and trusts hamper the determination of the legal nature of some tax planning schemes and the recovery of evaded taxes. In addition, financial institutions and professionals such as lawyers and accountants have been misused to hide the proceeds of tax evasion. While the anti-money laundering (AML) standard has long included provisions to pierce the veil, they have been extended to tax matters only recently. The synergies of the AML and revenue administration processes have strong potential but also present institutional challenges in terms of domestic and international cooperation.

C. Spillovers and Tax Competition

13. These international avoidance and evasion problems are instances of the cross-country spillovers arising from interactions between national tax systems. Aggressive tax planning and evasion imply that tax measures adopted in one country—the provision of regimes favoring the use of conduit companies, for instance, or low withholding taxes combined with reluctance to share information with other tax authorities—may undermine the revenues of others. Tax base thus shifts between countries, and in some cases almost entirely disappears. In the process, taxpayers and tax authorities often incur significant administrative costs, investment flows may well be distorted, and considerable talent is allocated to tasks of questionable social value.

14. But these spillover effects take many other forms too. Even if all tax provisions were fully complied with—in both spirit and letter of the law—real activities would potentially be distorted by incentives created by disparities and inconsistencies in national tax practices. Most obviously, and perhaps most fundamentally, changes in the overall level of business taxation in one country will likely affect levels of activity and revenue in others. But there are many other potential forms of spillover. A number of advanced countries, for instance, have moved or been urged to move away from a ‘residence-based’ system for taxing active business income, under which they tax such income arising abroad but give a credit for foreign taxes paid, to a ‘territorial’ one, under which they simply exempt such income. Such a shift can have significant implications for host countries, since any tax they charge will now remain as a final burden for the investor rather than be offset by reduced taxation in their home country—as a result, these countries, anxious to attract investment, may face greater pressure to offer tax incentives, lower tax rates, and take other measures that erode their revenue base.

15. The fundamental problem is the failure of national policies to take full account of the spillover effects on other countries—‘tax competition’ in a broad sense. Countries naturally seek to protect or expand their own tax bases, and attract or support economic activity in light of the policies pursued by others. The consequent strategic interaction between them in setting their tax policies—one country reacting to the policy choices of others (of which there is now ample evidence)⁸—implies a risk of mutually damaging ‘beggar thy neighbor’ outcomes. In

⁸ See for instance Devereux, Lockwood, and Redoano (2008).

the limit, one can conceive of such tax-setting leading all countries to have the same and perfectly aligned tax rates and base, with no compliance problems: there would then be no revenue loss from base erosion or profit shifting, residence based taxes would be perfectly enforced, and there would be no distortion of real decisions—yet there would still be a social harm suffered, since effective tax rates would be reduced below levels that a collective decision would have led to. While such an extreme outcome is of course unlikely in practice, the broader concern is already one that is routinely encountered: it largely explains, for instance, the prevalence of tax incentives of various kinds, which has been a recurrent concern in the Fund's work for many years.

16. Tax competition has some potential merit, but fiscal consolidation needs have sharpened policymakers' appreciation of its potential costs. The argument that international tax competition has a beneficial effect in constraining governments from raising too much revenue has a long intellectual pedigree,⁹ though why this should be superior to other and more explicit fiscal constraints is unclear. Variants of this view include the argument that tax planning has enabled promising firms to grow rapidly (at home, as well as abroad): in this view, it is, in effect, a way by which countries tax more mobile capital at a lower rate, consistent with the standard principle of taxing less heavily the more tax-sensitive tax bases.¹⁰ In general, the case for tax competition is weaker the greater is the marginal social value of tax revenue,¹¹ and to that extent will have become less persuasive given current needs for fiscal consolidation, with a greater recognition that reducing revenue losses from this source may be a relatively efficient and fair route to much-needed revenue. Differing national circumstances and interests can make it difficult to reverse collective damage from tax competition in such a way that all benefit, but this is not necessarily impossible: there are circumstances, for instance, in which minimum tax rates can benefit even those obliged to raise their tax rate.¹²

CURRENT GLOBAL INITIATIVES

17. A variety of measures addressed to these issues have been adopted at national and regional levels. Many countries, for instance, have adopted voluntary disclosure programs to encourage taxpayers to report undeclared assets offshore; the European Union requires members to provide information or levy withholding taxes on deposits held by residents of other member states; and some countries have canceled some of their tax treaties because of the perception that they were being abused.

⁹ The classic statement is in Brennan and Buchanan (1980).

¹⁰ For this and related arguments, see Desai, Foley, and Hines (2006) and Hong and Smart (2010).

¹¹ Edwards and Keen (1996).

¹² Because they benefit from the incentive for those not so constrained to raise their rates; Keen and Konrad (2013) review this issue.

18. Initiatives intended to have global participation are also underway. The two most important of these, now described, aim to address the tax planning and evasion issues above.

A. Base Erosion and Profit Shifting (BEPS)

19. Addressing BEPS has become one of the highest priorities of the international community. This was reiterated at the Lough Erne G-8 meeting, and the need to do so was stressed by G-20 leaders in their Los Cabos declaration of June 2012, which asked the OECD to report back on this issue.

20. The OECD will present a comprehensive action plan on BEPS to G-20 leaders at their July meeting.¹³ Likely areas of proposed action include: addressing mismatches in entity or instrument characterization; improvements to or clarifications of transfer pricing rules, including the treatment of intangibles; updated approaches to issues related to jurisdiction to tax, particularly in relation to digital goods and services; more effective anti-avoidance measures, including general anti-avoidance rules; rules on the treatment of intra-group financial transactions; and more effective actions to counter harmful tax regimes.

B. Information Exchange

21. The OECD Global Forum on Transparency and Exchange of Information for Tax Purposes (GF)—now with 120 members—promotes effective exchange of information (EOI), with automatic EOI becoming the new standard.¹⁴ Peer reviews examine whether a country complies with the internationally agreed standards of EOI, which prohibit a country from declining to provide information on grounds of bank secrecy. The G-8 and G-20 have called on all countries to adopt measures to facilitate automatic exchange of tax information, and mandated the OECD to develop the standard for this—which would be a substantial step forward, albeit one that faces considerable practical difficulty in implementation. Also important in this context is the opening of the Multilateral Convention on Mutual Administrative Assistance in Tax Matters—which covers all forms of EOI and assistance in tax collection—to all countries from 2013; it now covers more than 70 jurisdictions.

22. The OECD estimates an increase in tax revenue from offshore compliance initiatives in 20 countries of €14 billion in 2011.¹⁵ Some empirical work suggests that there has been a relocation of bank deposits from the most compliant tax havens to the least compliant.¹⁶

¹³ The Action Plan has been approved by the OECD's Committee of Fiscal Affairs.

¹⁴ More than 1,000 bilateral agreements have been concluded to include information exchange to the standard.

¹⁵ Opening remarks by the OECD Secretary-General at the Fourth Plenary Meeting of the Global Forum on October 25, 2011.

¹⁶ Johannesen and Zucman (2013).

23. The U.S. Foreign Account Tax Compliance Act (FATCA) is also having a major impact. This requires foreign financial institutions (FFIs) to report to the IRS information on financial accounts held by U.S. taxpayers, or by foreign entities in which U.S. taxpayers hold a substantial ownership interest.¹⁷ Non-compliant FFIs will face 30 percent withholding on all payments received from U.S. sources. The EU Commission recently proposed to expand automatic EOI between member states to ensure that the scope of EOI within the EU is at least as comprehensive as that between member states and the United States in the context of FATCA.

24. The Financial Action Task Force (FATF) has expanded the scope of money laundering predicate offenses to include tax crimes and stepped-up requirements related to the transparency of companies and trusts. The AML framework complements and supports the efforts of revenue administrations against tax evasion. An effective use of the AML framework should enhance compliance with tax laws by increasing the probability of detection of tax evaders, facilitating domestic and international cooperation, imposing deterring sanctions, and increasing revenues.

THE ROLE OF THE IMF

A. Mandates and Comparative Advantage

25. The OECD, by its history and expertise, is well placed to lead technical work on international taxation. Through its Committee on Fiscal Affairs (CFA), it has traditionally set consensual standards for its members—and indirectly for other countries—most notably for bilateral treaties and standards for avoiding abusive transfer pricing, though in other related technical matters as well. The IMF participates as an observer in the CFA, and staff maintains close and good links with their counterparts. The United Nations has played a significant but smaller role in this area, largely limited to the drafting and revision of the UN model tax treaty and transfer pricing guidelines, through its ‘committee of experts’ (in which Fund staff also often participate). The World Bank is increasing its TA on transfer pricing.

26. International tax issues are important for the Fund’s mandate, given their significance for macroeconomic stability at both the national and international levels. In particular, the Fund, in its surveillance, assesses whether members are pursuing policies that promote their own domestic and balance of payments stability, and whether their policies give rise to spillovers that may undermine global economic and financial stability. The impact of international tax policies on revenue mobilization—both directly and indirectly through effects on the rest of the tax system—as well as on investment and capital movements can have important implications for these assessments.

¹⁷ The United States has also concluded some intergovernmental agreements under which FFIs will report information on U.S. account holders to their national tax authorities (rather than to the IRS), who will in turn automatically provide this information to the IRS. This removes domestic legal impediments to compliance in partner countries and should reduce compliance burdens.

27. The Fund's comparative advantage in relation to international tax issues comes from its unparalleled TA experience on these issues, recognized expertise in their economic analysis, and the near-universal Fund membership. Progress on these sensitive issues requires a firm grasp of the technicalities, a strong analytical basis, and an understanding of the impact on widely differing countries, which the Fund is well equipped to provide.

B. Previous and Current Work

Technical assistance

28. International tax issues figure prominently in the Fund's demand-led TA in tax policy and administration. For some time, it has hardly been possible to analyze or implement corporate taxation without addressing international aspects: the persistence of tax incentives, for instance—a recurrent concern in much of the Fund's tax work—very largely reflects tax competition concerns. Box 2 provides a partial list of technical international tax issues encountered in recent TA; many of these are now dealt with as a matter of routine.

Box 2. IMF Technical Assistance in International Taxation

This has covered a wide range of topics and countries, a partial list including:

Transfer pricing issues: Bangladesh; Burkina Faso; Cambodia; Colombia; Dominican Republic; Egypt; El Salvador; Ethiopia; Greece; Guatemala; Malawi; Mauritania; Mongolia; Nicaragua; Panama; Ukraine.

Issues related to provisions of double taxation treaties: Burkina Faso; Costa Rica; Dominican Republic; Egypt; El Salvador; Georgia; Honduras; Indonesia; Malawi; Mauritania; Mongolia; Nepal; Panama; Uganda.

Capital gains across borders: Mongolia; various AFR natural resource intensive countries.

Holding companies, related party debt, thin capitalization, others: Bangladesh; Cambodia; Colombia; Egypt; Greece; Malawi; Portugal; Romania; Uganda; Ukraine.

Improving compliance and control of multinationals and high wealth individuals (HWIs): The establishment of large taxpayer offices, a key function of which is the control of major multinationals, has been a pervasive theme of revenue administration TA for many years; work on establishing units for HWIs is becoming increasingly common.

Drafting: The Fund has assisted several dozen countries in drafting individual and corporate income tax laws; all have involved drafting a full set of provisions dealing with all aspects of cross-border transactions.

29. IMF TA addresses these issues in a holistic context of wider reforms of tax policy, administration, and tax law drafting. While the current prominence of international taxation in public debate makes it an important focus of attention in many countries, it is important that the risks and opportunities be assessed realistically and responses designed in the context of the many other challenges facing policymakers and, especially, tax administrations. In relation to the

taxation of high wealth individuals, for instance, FAD TA addresses this in a context in which international considerations are an integral part of a much wider approach.

Policy development

30. Fund staff have worked on a wide range of aspects of international taxation:

- **Board papers** have raised international tax issues in the contexts of assessing links between taxation and the crisis and of meeting fiscal consolidation needs (respectively, IMF, 2009 and 2010).
- **Analytical work** of staff on international taxation is much-cited, covering a range of empirical and theoretical issues: it includes, for instance, work on spillover effects from corporate tax reform in advanced countries (Perry, Matheson, and Veung, 2013); the United States Staff Report for the 2013 Article IV Consultation (forthcoming); empirical work on tax interactions (Abbas and Klemm, 2013); empirical work on profit by European multinationals (Huizinga and Leuven, 2008), and a recent survey of the area (Keen and Konrad, 2013).¹⁸
- **Technical work** includes a book in progress on international tax regimes for the extractive industries, together with work on the implementation of arms-length pricing (Schatan, 2010) and on domestic law aspects of tax treaties (Nakayama, 2011).

AREAS FOR FUTURE WORK

31. Work planned is guided by the IMF's mandate and comparative advantage—and will complement and enlighten, not supplant, the current initiatives described above. It will have three main components.

A. Paper on “Spillovers in International Taxation”

32. This will identify the nature and extent of the cross-country impact of national policies and practices in international taxation, and assess current and possible responses.

While the focus will be on international corporate taxation, the strong links with elements of national tax systems mean that aspects of domestic policy will also need to be recognized.

¹⁸ Other relevant work includes work on: the fundamentals of tax competition games (Kanbur and Keen, 1993; Kempf and Rota Graziosi, 2012); tax treaties (Thuronyi, 2010); the impact of preferential tax regimes (Keen, 2001) and of information sharing (Keen and Ligthart, 2006); meta-analysis of tax effects on foreign direct investment (de Mooij and Ederveen, 2003); the empirics of debt-shifting (Huizinga, Leuven, and Nicodème, 2008); special issues in the resources sector (Mullins, 2010); and tax competition in WAEMU, the Caribbean, and Latin America (Mansour and Rota Graziosi, 2012; Klemm and van Parys, 2012).

33. The paper will focus on a series of under-studied issues critical to the future development of the international tax system, in both short and longer terms. There is a large theoretical literature on spillovers and international tax competition, which the paper will draw on and review; but it remains at a high level of abstraction; and empirical work remains in its infancy. The planned work complements work underway elsewhere, especially at the OECD, by addressing overarching design and implementation issues that need to be faced if the fundamental problems arising from international tax spillovers are to be resolved. These can be broadly grouped under two headings:

Understanding and assessing tax spillovers

- While the revenue implications (direct and indirect) of interactions are the primary concern, attention will also be given to issues of financial stability and effects on growth and development. The former include, for instance, effects on the structure and financing of financial institutions—and a better understanding and quantification of tax-induced cross-country flows more generally; the latter include, in addition to wider spillover issues raised above, the potential vulnerabilities of jurisdictions whose business model relies on facilitating tax planning and now may face reorientation.
- Developing countries face particular challenges in dealing with sophisticated multinationals, and responding to international initiatives, in a context of limited capacity. These problems have received little systematic attention, so that it is often unclear how extensive the challenges are or how measures to address them should be designed and prioritized within wider programs of administrative reform.
- Attention has often focused on interactions through differences or changes in headline corporate tax rates but in tax planning terms, these are far from being the sole concern. Much less attention has been paid to the revenue and other implications—both in aggregate and for particular types of country—of other provisions, which are often quite technical. These include, for instance, the wider design of international tax regimes (territorial or worldwide), treaty shopping, and hybrid mismatches.
- As well as—and as a step toward—better understanding how these issues may affect particular countries, it is important to assess their likely impact in particular sectors: including, for instance, the extractive industries, telecoms, and financial institutions—the core of the corporate tax base in many countries. A fuller understanding of the importance of and challenges posed by the taxation of these sectors, and of multinationals more widely, is much needed, especially in many developing countries.
- There are links too with wider aspects of corporate tax design. For example, addressing the asymmetric treatment of debt and equity, which IMF (2009) and others¹⁹ have argued for on other grounds, would also close some planning opportunities (though in ways that would depend on precisely how this is done). And the appropriate corporate tax policy

¹⁹ Such as the Mirrlees review of the U.K. tax system (Mirrlees and others, 2010).

- for developing countries may need to be revisited given advanced countries' shift away from granting credits against domestic tax for taxes paid abroad, since this reduces the importance of ensuring their corporate tax is so designed as to meet conditions for creditability.
- By expanding the scope of the money laundering predicate offenses to tax crimes, the revised FATF standard opens new avenues to fight tax evasion. However, in most countries, there is a need for a cultural change in the work processes of AML and the tax authorities in order to meaningfully unlock the potential for revenue collection. Fund staff is currently working on these issues with some members in the context of surveillance and Fund-supported programs. The subject deserves further study and the development of general policy recommendations.
 - A 'second best' issue arises: Closing down some means of aggressive tax planning may induce countries to engage more intensely in other forms of tax competition, limiting and conceivably even reversing the consequent gains.²⁰ Should this be a real concern?

Dealing better with spillovers: Toward an improved international tax framework

- There is considerable interest among civil society organizations and others in more radical alternatives to the current international tax framework, such as 'formulary apportionment' (allocating a multinational's global profits among countries by some formula intended to proxy its 'real' relationships with those in which it operates, not by a transactional arms-length basis) and some form of minimum taxation. Even if the conclusion is that these are infeasible or undesirable, such schemes—including their impact on developing countries—deserve a more thorough and realistic assessment.
- Other suggestions deserving close attention—more in the nature of 'fixes' than deeper improvements—include wider use of minimum taxes and denial of deductions as a response to profit shifting.
- The general strategy of building an international tax structure around bilateral tax treaties is being increasingly questioned. Key issues are when and whether domestic legislation can achieve the same effects in better ways, and whether there is scope for increased multilateralism.
- The active but sometimes confused debate on 'country-by-country' reporting raises questions as to whether countries—especially developing—have, or under current arrangements, can obtain information needed to protect against erosion of their tax bases. Beyond this are wider issues as to how best administrations can assess and address the challenges of international taxation that they face, including in dealing with current initiatives, in the wider context of their broader efforts to strengthen revenue mobilization.

²⁰ The general point here is that partial coordination is not necessarily beneficial even if full coordination would be: see Keen and Konrad (2013).

- Overarching all these questions is that of whether the spillovers, and countries' reactions to them, are large enough to warrant deeper and fuller cooperation on international tax matters—and if so, given the great sensitivities in tax matters, what form might it take? There may be lessons to draw from various regional efforts at this cooperation, several of which the Fund continues to be closely involved in.

B. Inform and Contribute to Technical Discussions

34. FAD has traditionally drawn on its fiscal expertise and TA experience to encourage and inform debate on technical tax issues. Drawing on its extensive and increasing TA to a wide range of members, the Fund is in a unique position to set out technical issues and possible approaches, fully integrated in its wider country TA programs and wider dialogue.

35. Various technical contributions are planned. These include, in addition to the work already underway described above, pieces on tax treaties (where new thinking is underway, and evident in Fund TA) and transfer pricing (where the Fund has experience in assessing how risks can be addressed in circumstances of limited capacity). Other technical pieces are expected to emerge, providing further background for the wider paper on spillovers.

C. Encourage and Contribute to the Wider Debate

36. There will be extensive consultation and outreach in preparing the 'spillovers' paper and technical materials, and in communicating the results. Existing dialogue on these issues with country authorities, other organizations active in the area, academics, civil society, and business will be intensified. Stressing the collaborative intent of the Fund's work, the intention is that a good part of this work would be developed in combination with the OECD²¹ and others, including the World Bank and United Nations, active in the area. FAD will work closely with COM on communication issues.

²¹ The OECD's BEPS Action Plan includes work to establish methodologies to collect and analyze data on BEPS and the actions to address it (Action 11).

QUESTIONS FOR DIRECTORS

1. Do Directors agree that the Fund's involvement in international tax issues should focus on macro-relevancy, spillovers, and TA-related aspects?
2. Which areas of work set out in Section IV do Directors see as priorities?
3. Are there issues not raised in the paper that require staff's attention?

References

- Abbas, Ali, and Alexander Klemm, 2013, "A Partial Race to the Bottom: Corporate Tax Developments in Emerging and Developing Economies," *International Tax and Public Finance*, forthcoming.
- Brennan, Geoffrey, and James M. Buchanan, 1980, *The Power to Tax: Analytical Foundations of a Fiscal Constitution* (Cambridge: Cambridge University Press)
- de Mooij, Ruud A., and Sjef Ederveen, 2003, "Taxation and Foreign Direct Investment," *International Tax and Public Finance*, Vol. 10, pp. 673–93.
- Desai, Mihir, C. Fritz Foley, and James R. Hines Jr., 2006, "The Demand for Tax Haven Operations," *Journal of Public Economics*, Vol. 90, pp. 513–31.
- Devereux, Michael, Ben Lockwood, and Michela Redoano, 2008, "Do Countries Compete Over Corporate Tax Rates?" *Journal of Public Economics*, Vol. 92, pp. 1210–35.
- Dharmapala, Dhammika, and Nadine Riedel, 2013, "Earnings Shocks and Tax-motivated Income-shifting: Evidence from European Multinationals," *Journal of Public Economics*, Vol. 97, pp. 95–107.
- Gravelle, Jane G., 2013, "Tax Havens: International Tax Avoidance and Evasion," Congressional Research Service Report for Congress.
- Hong, Qing, and Michael Smart, 2010, "In Praise of Tax Havens: International Tax Planning and Foreign Direct Investment," *European Economic Review*, Vol. 54, pp. 82–95.
- Huizinga, Harry, and Luc Laeven, 2008, "International Profit Shifting within European Multinationals: A Multi-Country Perspective," *Journal of Public Economics*, 92(5–6), 1164–82.
- Huizinga, Harry, Luc Laeven, and Gaetan Nicodème, 2008, "Capital Structure and International Debt Shifting in Europe," *Journal of Financial Economics*, Vol. 88(1), pp. 80–118.
- International Monetary Fund, 2013, "United States: Article IV Consultation Staff Report," forthcoming (Washington: International Monetary Fund).
- _____, 2010, "From Stimulus to Consolidation: Revenue and Expenditure Policies in Advanced and Emerging Economies," available at <http://www.imf.org/external/np/pp/eng/2010/043010a.pdf> (Washington: International Monetary Fund).
- _____, 2009, "Debt Bias and Other Distortions: Crisis-Related Issues in Tax Policy," available at <https://www.imf.org/external/np/pp/eng/2009/061209.pdf> (Washington: International Monetary Fund).

- Johannesen, Niels, and Gabriel Zucman, 2013, "The End of Bank Secrecy? An Evaluation of The G20 Tax Haven Crackdown," *American Economic Journal: Economic Policy*, forthcoming.
- Kanbur, Ravi, and Michael Keen, 1993, "Jeux sans Frontières: Tax Competition and Tax Coordination when Countries Differ in Size," *American Economic Review*, Vol. 83, pp. 877–92.
- Keen, Michael, 2001, "Preferential Regimes can make Tax Competition Less Harmful," *National Tax Journal*, Vol. 54, pp. 757–62.
- Keen, Michael, and Kai Konrad, 2013, "The Theory of International Tax Competition and Coordination," forthcoming in Alan Auerbach, Raj Chetty, Martine Feldstein, and Emmanuel Saez (eds) *Handbook of Public Economics*, Vol. 5 (North Holland: Amsterdam).
- Keen, Michael, and Jenny Ligthart, 2006, "Information Sharing and International Taxation: A Primer," *International Tax and Public Finance*, Vol. 3, pp. 81–110.
- Kempf, Hubert, and Grégoire Rota Graziosi, 2010, "Endogenizing Leadership in Tax Competition," *Journal of Public Economics*, Vol. 94, pp. 768–76.
- Klemm, Alexander, and Stefan van Parys, 2012, "Empirical Evidence on the Effects of Tax Incentives," *International Tax and Public Finance*, Vol. 19, pp. 393–423.
- Lane, Philip R., and Gian-Maria Milesi-Ferreti, 2007, "The External Wealth of Nations Mark II: Revised and Extended Estimates of Foreign Assets and Liabilities, 1970–2004," *Journal of International Economics*, Vol. 73, pp. 223–50.
- Mansour, Mario, and Grégoire Rota Graziosi, 2012, "Coordination Fiscale dans l'Union Économique et Monétaire Ouest-Africaine," *Revue d'économie de développement*, Vol. 26, pp. 9–34.
- Mirrlees, James, Stuart Adam, Timothy Besley, Richard Blundell, Stephen Bond, Robert Chote, Malcolm Gammie, Paul Johnson, Gareth Myles, and James Poterba, 2010, *Tax by Design: The Mirrlees Review* (Oxford University Press : Oxford).
- Mullins, Peter, 2010, "International Tax Issues for the Resources Sector, " in Philip Daniel, Michael Keen, and Charles McPherson (eds), *The Taxation of Petroleum and Minerals: Principles, Problems, and Practice*, pp. 378–402 (Routledge: Abingdon).
- Nakayama, Kiyoshi, 2011, "Tax Policy: Designing and Drafting a Domestic Law to Implement a Tax Treaty," IMF Technical Notes and Manuals No. 11/01. Available at <http://www.imf.org/external/pubs/cat/longres.aspx?sk=24653.0> (Washington: International Monetary Fund).
- Organization for Economic Cooperation and Development, 2013, *Addressing Base Erosion and Profit Shifting* (Paris: OECD).

Perry, Victoria, Thornton Matheson, and Dara Veung, 2013, "Territorial vs. Worldwide Corporate Taxation: Implications for Developing Countries?" forthcoming in conference volume.

Schatan, Roberto, 2012, "Tax-Minimizing Strategies and the Arm's Length Principle," *International Tax Notes*, January 9, pp. 121–26.

Thuronyi, Victor, 2010, "Tax Treaties and Developing Countries," in *Tax Treaties: Building Bridges between Law and Economics*, by Michael Lang et al (eds).

Zucman, Gabriel, 2013, "The Missing Wealth of Nations: Are Europe and the U.S. Net Debtors or Net Creditors?" *Quarterly Journal of Economics*, forthcoming.