Policy Note

Strengthening tax systems

"Taxes need to be fair, as well as low, in order to preserve the legitimacy of free markets."

Australian Prime Minister Tony Abbott, World Economic Forum, Davos, January 2014

The digital economy is changing the tax environment

A robust and efficient international tax system is an important element of global economic resilience. Governments in developed and developing economies alike rely on revenue from taxation to fund infrastructure, provide services to their communities, and respond to economic challenges and shocks.

Increased globalisation and the growth of the digital economy has seen the evolution of new businesses and new ways of doing business.

Multinational enterprises now account for around 25 per cent of world GDP.

The OECD estimates that low-income countries are dependent on corporate tax for 20 per cent of their tax income, compared to 8-10 per cent for developed countries.

On average, developing countries raise 17 per cent of GDP in taxes. By contrast, the average OECD member tax-to-GDP ratio is about 34 per cent.

Some multinationals use strategies that allow them to pay as little as 5 per cent in corporate taxes when smaller businesses are paying up to 30 per cent.

Source: OECD

SUSTAINABLE GROWTH DEPENDS ON A FAIR TAX SYSTEM

TAX AVOIDANCE IS A GLOBAL ISSUE

Corporate taxing rights stem from the principle that tax should be paid in the country where profit is earned.

Multinationals can avoid paying tax through aggressive tax planning strategies that exploit gaps and mismatches in tax arrangements between countries. These strategies seek to shift the declaration of profits to locations where they are taxed at lower rates, and claim expenses where they are relieved at higher rates. The result is that some multinational companies are paying little or no tax on their income.

These tax avoidance practices, while legal, threaten the integrity of, and community trust in, tax systems, leaving governments with less revenue and distorting competition by allowing some types of companies to obtain profits where others cannot.

A solution is beyond the ability of any one country to implement if acting alone. A global solution – one that works for G20 members and non-members alike – is needed to addresses problems in the international tax system.

IMPROVING THE INTERNATIONAL TAX SYSTEM

In 2013, G20 leaders endorsed the G20 and OECD Base Erosion and Profit Shifting (BEPS) project to close loopholes in the international tax systems.

Through this, the G20 is working to ensure that company profits are taxed where the economic activities deriving those profits are performed and where value is created. By implementing the G20-OECD BEPS Action Plan over 2014-15, governments are putting in place, in consultation with business and non-government stakeholders, instruments to reduce tax avoidance and improve the coherence of the global tax system.

G20-OECD BEPS ACTION PLAN

The measures under the G20-OECD Base Erosion and Profit Shifting (BEPS) Action Plan due in 2014 will:

- focus on clearer reporting by multinational enterprises of tax information – including profits across different countries – to increase transparency and fight tax avoidance ('country-by-country reporting');
- identify the challenges for tax systems posed by the digital economy and ways to address them;
- tackle arrangements that exploit differences in the tax treatment of instruments, entities or transfers between countries; and
- develop rules to combat practices that shift intangible assets (such as intellectual property) to other companies.

The remaining actions will be delivered in 2015.

IMPROVING EXCHANGE OF TAX INFORMATION THROUGH A GLOBAL STANDARD

To increase transparency in tax systems and act as a deterrent to tax evasion by private citizens, G20 Finance Ministers endorsed a new global common reporting standard for the automatic exchange of tax information (AEOI), and agreed in September 2014 to begin exchanging information automatically between G20 countries and with other countries by 2017 or the end of 2018. Easy access to useful information is key to prevent cheating of the tax system.

The AEOI standard (being developed in consultation with business to minimise compliance costs) will require banks and other financial institutions to report residents' financial information across jurisdictions, including tax incurred outside the country where they lodge their tax return. This will help tax administrators build a comprehensive picture of the financial arrangements of their residents.

Tax authorities currently share information – either on request, spontaneously or automatically. Standardising the type and format of information exchanged, as well as improving timeliness, will improve the usefulness of information being exchanged, while maintaining privacy.

The AEOI standard will also ensure taxpayers and financial institutions only need to engage with one globally accepted standard, rather than multiple separate jurisdictional approaches.

RELIABLE TAX REVENUE IS KEY TO DEVELOPMENT

The G20 is working with low income and developing countries to strengthen their tax administration capacity and support them to participate in and benefit from the BEPS and AEOI reforms. This will help to increase tax revenues to help finance essential services in developing countries and help reduce reliance on aid. According to the IMF, official development assistance amounts to around 20-40 per cent of tax revenues in developing countries.

ENSURING TRANSPARENT OWNERSHIP

Complementing these measures is work to ensure the ownership of legal entities is transparent so that it is clear who enjoys the benefits of owning a company or particular asset (known as 'beneficial ownership'). This transparency is the key to preventing these assets from being used for money laundering, tax evasion or other corrupt activities, and help protect the tax bases of G20 and other countries as it will improve revenue management and strengthen investment climates for developed and developing countries alike.

HOW IT HAPPENS

G20 members work on the tax agenda through the finance and central bank deputies process, supported by relevant working groups, and in close cooperation with international organisations. The OECD leads work on BEPS, tax transparency and tax administration, providing analysis and reporting to the G20.

The Global Forum on Transparency and Exchange of Information for Tax Purposes, with 122 member countries, is the key multi-lateral body for implementing internationally agreed standards of transparency and exchange of information between tax authorities.

The G20 has raised awareness and gathered a broad range of perspectives on the G20 tax agenda, for example through the G20-led International Tax Symposium in Tokyo in May 2014.

G20 members will report on progress in implementing the 2014-2015 BEPS Action Plan at the Finance Ministers and Central Bank Governors meeting in September 2014 and to leaders in November 2014.

They will also detail their AEOI implementation plans and report on steps to enhance transparency of beneficial ownership.

- prepared by the Australian Presidency

Further information

Website: G20.org

Facebook: facebook.com/G20Australia2014

Twitter: @G20Australia

Email: G20info@pmc.gov.au

G20 Infoline: 1800 922 011 (toll-free in Australia)