The 5th IMF-Japan High-Level Tax Conference for Asian Countries

Principles of and Lessons from Regional Harmonization of Tax System

Kiyoshi Nakayama
IMF Fiscal Affairs Department

Tokyo, Japan
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Context

- ASEAN will form a common market– the ASEAN Economic Community (AEC) in 2016
- SAARC: South Asian Free Trade Area (SAFTA) aims to make customs zero in 2016 and aims at a single market in 2020 (?)
- Tax harmonization/coordination is key to enhance the functions and operation of a single market.
- Then, what should/could be done in tax areas?
- Experiences in other regional economic community could provide lessons.
- Only discuss tax policy aspects; regional cooperation in tax administration is indisputable; a role of Convention on Mutual Administrative Assistance in Tax Matters

Outline

- Economic Integration Process
- Why is tax harmonization/coordination necessary for regional integration?
- Overview of efforts to harmonize/coordinate tax system in other regional economic communities
  - EU
  - WAEMU
  - SADC
- Lessons
- Is full harmonization desirable or viable?
- Should intra-region capital flows be tax free?

Economic Integration Process

1) Preferential trade area
2) Free trade area
3) Custom Union
4) Common market
5) Economic and monetary union
6) Complete economic integration

(Balassa)

Why is tax harmonization/coordination necessary for regional integration?

- To avoid tax distortions to the location of economic activity within the single market
- To ensure that the single market operates as smoothly
  - Tax harmonization/coordination efforts are centered on removing obstacles to the smooth functioning of the single market: free movement of goods, services and capital
- To stabilize revenue

Overview of efforts to harmonize tax system in other regional economic communities

EU

- No need for an across the board harmonization of tax systems, and Member States are free to choose the tax system. (the subsidiarity principle of the EC Treaty
- But, Member States are refrained from introducing any new harmful tax measures and required to amend the existing harmful tax measures (Code of Conduct – soft law)
- Prohibition of State Aid could have stronger impacts on tax incentives.
- VAT
  - Maximum rate: 25% (informal); Minimum standard rate: 15%;
  - Member States may apply one or two reduced rates of not less than 5%
- Excises
  - Alcohol beverages: minimum rate e.g. Beer=€0.0935 per liter;
  - Cigarettes: minimum rate=57% of a retail price + new proposal

Overview of efforts to harmonize tax system in other regional economic communities (cont.)

EU (cont.)

- Paying agents (e.g. banks) need to either report interest income received by a resident in other EU Member States or levy withholding tax on the interest income (Saving Directive) → Automatic exchange of information
- Dividends paid by a subsidiary company (sub) to its parent company (parent) are exempted from withholding tax if the parent hold at least 10% of the shares in the sub; the Member State of the parent had either: exempt profits distributed by the sub from any taxation or impute the tax already paid in the Member State of the sub against its own tax. (Parent-Subsidiary Directive)
- Common Corporate Consolidated Tax Base (CCCTB)

  - ECOFIN's report to European Council (2013)
- European Court of Justice – powerful guardian of EC Treaty

Overview of efforts to harmonize tax system in other regional economic communities (cont.)

WAEMU (West African Economic and Monetary Union)

Benin, Burkina Faso, Cote d'Ivoire, Mali, Niger, Niger, Senegal, Togo, and Guinea-Bissau

- Macro-fiscal condition: primary balance should not exceed zero; debt-to-GDP ratio should not exceed 70%; tax revenue-to-GDP should be at least 17%
- Single currency (CFAF)(before formation of WAEMU)
- Custom Union (2000)
- VAT
  - Single positive VAT rate between 15% and 20%
  - Registration threshold
  - Common rules for tax base
- Excises
  - Minimum and maximum tax rates by type of goods

Overview of efforts to harmonize tax system in other regional economic communities (cont.)

WAEMU (cont.)

- CIT
  - Single rate between 25% to 30%
  - Standard CIT base
- Portfolio income
  - Withholding tax on dividends:10% to 15%; interest: 0% to 6%: capital gains: 0% to 7%
- Multilateral tax treaty
  - Ceiling rate on interest and royalties:15%; dividends: 10%

❖ No directives/regulation on tax incentives provided by non-tax laws

❖ Commission nor member states have never brought a case of non compliance with tax directives to the regional Court of Justice

Overview of efforts to harmonize tax system in other regional economic communities (cont.)

SADC (Southern African Development Community)

Angola, Botswana, the Democratic Republic of the Congo, Lesotho, Madagascar, Malawi, Mauritius, Mozambique, Namibia, Seychelles, South Africa, Swaziland, United Republic of Tanzania, Zambia and Zimbabwe

- SADC Tax Database (http://www.sadc.int/information-services/tax-database)
- Guidelines on tax incentives
  - "State Parties shall…endeavour to avoid (a) harmful tax competition…"(Protocol Annex 3, Article 4)
- Double Taxation Agreement
  - Model DTA for SADC
  - "State Parties shall …establish amongst themselves a comprehensive network of DTA" (Article 5)
- Indirect taxes
  - "Each State party shall, in an effort to minimise..smuggling… harmonise the application of excise rates.." (Article 6(5))
  - "State parties shall …harmonize..VAT regimes…"(Article 6(10))
- Dispute settlement mechanism

Lessons

- Without strong political commitment, it is difficult to achieve effective harmonization/coordination.
- Priority should be given to excises and CIT and tax incentives.
- Soft law approaches such as Code of Conduct are pragmatic, but rely on goodwill and peer pressure, and are thus inherently difficult to enforce.
- Information sharing is a pre requisite for any harmonization/ coordination efforts.
- Institutional arrangements and surveillance mechanism is key to achieve and maintain tax harmonization/coordination
- Tax harmonization/coordination should cover de facto tax laws.

Is full harmonization desirable or viable?

- Full harmonization of tax is:
  - Equalization of tax rates
  - Common definition of national tax base
  - Uniform application of agreed rules
- Should a regional economic community dictate all country tax rates and other details at a stage of a common market or an economic and monetary union?
- Is it possible to enforce such harmonization? Is it desirable to have a huge regional institution to monitor compliance by member states?

Should intra-region capital flows be tax free?

- A DTA network, intra-region DTA, or bilateral DTAs need to cover all community members. It is desirable that bilateral DTAs among member states be identical.
- If an intra-region or bilateral DTAs exempt source country taxation on investment income, it would facilitate further integration.
- However, unless there is the “harmonization” of CIT structure, in particular, tax incentives, it would induce further concentration to a business friendly member state or provide an opportunity for tax avoidance.
- Proliferation of “sandwich” schemes in EU could indicate a risk of exempting source country taxation on dividends.

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