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Tax certainty: proposals for the short term and the long term

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Abstract
Tax certainty aims at the stabilization of expectations of both, taxpayers and governments. Improving tax payer service, easing cooperation channels and clarifying legal framework are strategies already in place to increase tax certainty, even though to different extent depending on the countries level of development. For the short run, concrete measures can be recommended through which international cooperation can contribute to strengthening tax certainty. These measures concern the establishment of enhanced engagement programs, the development of model legislation as a tool for the implementation of international rules and standards, the alignment of bilateral treaties and domestic legislation to international good practices, using the country-by-country-report as an indicator for the adequacy of tax payments and setting up investment incentives. In the long run, a radical change in the international tax scheme is suggested since, amongst others, the current rules do not match with the emerging digital economy. A unitary taxation system might be therefore the appropriate response even if the implementation on an international level is complex.

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1 Definition, background and challenge

Tax certainty refers to the creation and maintenance of stable regulatory and policy frameworks for tax administration, taxpayers and tax compliance. In developed and developing countries alike, a climate of mistrust tends to exist between society at large and multinational enterprises (MNEs) relating to allegations of large scale tax avoidance by MNEs, and leading to a combative environment between the wider public, business and governments over tax policy and implementation. In developing countries, this confrontational setting is particularly damaging as many governments depend to a large degree on tax payments of MNEs. Furthermore, both domestic and foreign direct investments are affected by situations where frequent changes in tax legislation and inconsistent and sometimes coercive implementation practices in tax administrations have negative repercussions on investment risk assessments and investment financing.

It is therefore essential to identify efficient processes through which mutual transparency, justified trust, better understanding of taxpayer's businesses and thus more effective risk management can be implemented to facilitate economic growth and domestic resource mobilization.

Measures to increase tax certainty aim at the stabilization of expectations of both, taxpayers and governments. From an investor's perspective, reliable and stable tax policies and a predictable behaviour of tax administrations are important factors for doing business in a country. Thus, tax certainty is crucial to stimulate economic growth and job opportunities. From a government perspective, the willingness of companies to pay their fair share of taxes to finance public services is an important element of sound public finance systems. In this sense, tax certainty stands for the predictability of tax regimes, but also for the certainty that taxpayers will be appropriately taxed. Thus, tax certainty matters for companies as well as for tax authorities (IMF & OECD, 2017, 26–37).

Against this background, it should be clear that tax certainty does not equal the cessation of all tax reform activities. Also, it should not be mistaken as a toolbox for individual deals between investors and governments to lower the tax burden of private sector companies. Rather, tax certainty should be understood as a common framework of rules and procedural standards geared to create a level playing field and provide long-term conditions suitable for investment.

Tax certainty is a concern for individual governments, who should produce effective and fair tax laws and regulations, provide capable tax and customs administrations and set up swift and transparent mechanisms for dispute resolution. However, it is also an issue for international tax cooperation, geared towards

- Avoiding double taxation and the uncertainty stemming from a company's interaction with different tax systems,
- Avoiding double non-taxation through aggressive tax planning strategies, the use of secrecy, the exploitation of regulatory loopholes and the excessive reliance on ad-hoc and opaque rulings

- Providing shared and transparent standards for mechanisms that seek to avoid conflicts between tax authorities and taxpayers
- Assisting in the implementation of international rules and standards and in the adaptation of tax systems to changing business environments.

2 Tax administrations' activities

Tax certainty implies multiple aspects, being by nature a multidimensional strategy. In this section we analyze the reality of tax administrations in this area, using the recent data available (2015) through ISORA, the International Survey on Revenue Administration,[1] to describe the scenario[2] where the measures proposed in the following sections fall within. One hundred and twenty-five countries and jurisdictions are considered, grouped by level of income, using World Bank classification[3] into high (38.4% of the countries surveyed), upper middle (26.4%), lower middle (18.4%) and low income (16.8%).[4]

Three dimensions linked to tax certainty are considered in this panorama: Tax payer rights and services, cooperative compliance strategies and alternative dispute resolution channels, rulings and special regimes or segmentations.

1. ISORA has emerged from the joint effort of the IMF, IOTA, OECD and CIAT, as a homogeneous survey addressed to the revenue administrations. The survey collects collection data, institutional structure, budget and human resources, segmentation and taxpayer registration, returns filing and payments, taxpayer assistance and tax education, enforced collection of debts, inspection, audit, and investigation of tax fraud and dispute resolution mechanisms.

2 A more in-depth analysis of Tax Administrations' activities in this area will be available in "Making it easier: taxpayer services, cooperative compliance and tax simplification" by Santiago Díaz de Sarralde, CIAT-Working Papers, march 2018.

3 "Economies are divided into four income groupings: low, lower-middle, upper-middle, and high. Income is measured using gross national income (GNI) per capita, in U.S. dollars, converted from local currency using the World Bank Atlas method. Estimates of GNI are obtained from economists in World Bank country units; and the size of the population is estimated by World Bank demographers from a variety of sources, including the UN's biennial World Population Prospects." World Bank Data.

4 Income groups:

- High income (48): Anguilla, Antigua and Barbuda, Australia, Austria, Barbados, Belgium, Canada, Chile, China, P.R.: Hong Kong, Cook Islands, Cyprus, Czech Republic, Denmark, Estonia, Finland, France, Germany, Greece, Hungary, Iceland, Ireland, Israel, Italy, Japan, Republic of Korea, Latvia, Lithuania, Luxembourg, Malta, , Netherlands, New Zealand, Norway, Poland, Portugal, Seychelles, Singapore, Slovak Republic, Slovenia, Spain, St. Kitts and Nevis, Sweden, Switzerland, Trinidad and Tobago, Turks and Caicos Islands, United Kingdom, United States, Uruguay, Virgin Islands British.
- Upper middle income (33): Argentina, Belize, Brazil, Bulgaria, China, P.R.: Mainland, Colombia, Costa Rica, Croatia, Dominica, Dominican Republic, Ecuador, Equatorial Guinea, Fiji, Gabon, Grenada, Jamaica, Malaysia, Maldives, Mauritius, Mexico, Namibia, Panama, Paraguay, Peru, Romania, Russian Federation, Samoa, South Africa, St. Lucia, St. Vincent and the Grenadines, Suriname, Tonga, Turkey.
- Lower middle income (23): Angola, Bolivia, Cameroon, Republic of Congo, Côte d'Ivoire, El Salvador, Ghana, Guatemala, Honduras, India, Indonesia, Kenya, Lesotho, Mauritania, Morocco, Myanmar, Nicaragua, Nigeria, Papua New Guinea, Solomon Islands, Swaziland, Vanuatu, Zambia.
- Low income (21): Benin, Burkina Faso, Burundi, Central African Republic, Chad, Democratic Republic of Congo, Ethiopia, The Gambia, Guinea, Republic Guinea, Liberia, Madagascar, Malawi, Mali, Niger, Rwanda, Senegal, Sierra Leone, Tanzania, Togo, Uganda

Establishing tax payer rights and improving services to facilitate tax compliance undoubtedly could improve voluntary compliance and reflect an increase in tax certainty. Tax administrations seem to be in line with this strategy and close to eighty per cent (78.4%) of them declare to have stablished a document that formally sets out taxpayer rights, with no significant differences across income levels (Table 1). Nevertheless, some outstanding differences arise concerning the existence of a formal body to deal with complaints (75% of high income tax administrations; 47% in low income countries), and, in general, the number of Tax administrations where this body is autonomous and external drops dramatically (only 28.8% on average).

When the presence of a formal set of delivery standards is considered, more than 70% of administrations answer positively (again regardless of income levels), but the percentages collapse when they are asked about the publication of the results obtained pursuing those standards (just 36%, ranging from 45.8% – high income – to just 19% – low income).

The last two columns of Table 1 show that 77.6% of tax administrations have stablished a formal taxpayer service and assistance strategy and that nearly seventy per cent of them consider increasing tax payer certainty a high priority. Table 2 completes this overview. Around 80% of tax administrations use satisfaction surveys to control results both on business and individuals, even if the percentages drop to fifty per cent in the case of surveys conducted by external vendors and when their publication is considered.

Cooperative compliance strategies (Table 3) are present in around half of the tax administrations[5], standing out their relevance among low income countries, where two out every

Table 1. Tax payer rights, complaints, delivery standards and service assistance

Countries	Tax Payers Rights	Body deal with complaints	Body autonomous and external	Formal delivery standards	Delivery standards results published	Tax payer service and assistance strategy	Tax payer certainty High priority
TOTAL	78.4	66.4	28.8	75.2	36.0	77.6	69.1
High Income	77.1	75.0	43.8	75.0	45.8	81.3	69.2
Upper middle	72.7	72.7	18.2	75.8	36.4	81.8	77.8
Lower middle	82.6	56.5	17.4	78.3	30.4	87.0	55.0
Low Income	85.7	47.6	23.8	71.4	19.0	52.4	72.7

Source: ISORA (2015) and own elaboration

5 And more than sixty percent consider cooperative compliance a high priority approach.

Table 2. Tax payers' satisfaction surveys

Countries	Satisfaction surveys-individuals	Satisfaction surveys-business	Surveys External individuals	Surveys External Business	Surveys published-Individuals	Surveys published-Business
TOTAL	82.4	78.8	49.4	48.2	50.6	47.1
High Income	83.9	74.2	51.6	45.2	64.5	58.1
Upper middle	80.8	76.9	50.0	50.0	38.5	34.6
Lower middle	83.3	83.3	44.4	50.0	44.4	38.9
Low Income	80.0	90.0	50.0	50.0	50.0	60.0

Source: ISORA (2015) and own elaboration

Table 3. Cooperative Compliance

	Cooperative compliance approach				Nature of coop. compliance model		
Countries	In place	Implementing	Planning	TOTAL	Enhance relation	Formal agreement	Specific regulation
TOTAL	26.4	12.0	16.0	54.4	31.2	19.2	20.8
High Income	35.4	14.6	8.3	58.3	29.2	27.1	10.4
Upper middle	12.1	9.1	21.2	42.4	27.3	12.1	21.2
Lower middle	30.4	4.3	17.4	52.2	39.1	17.4	30.4
Low Income	23.8	19.0	23.8	66.7	33.3	14.3	33.3

Source: ISORA (2015) and own elaboration

three have already implemented, are now implementing or are planning to introduce this approach. Concerning the nature of the cooperative compliance models, the non-formal strategy – enhance relationships – is the most popular, followed by specific regulations – legal framework – and formal agreements. As complementary to these cooperative strategies, alternative dispute resolution forums are in place in only 20% of the tax administrations (classical civil, criminal and administrative courts continue to be the preferred channels), but it must be highlighted that the percentage presents an inverse relation with the income level (12.5 in high income countries, 18.2 in high middle, 21.7 in low middle, and 38.1% in low income jurisdictions)

When it comes to solve doubts on the practical interpretation of tax law, most tax administrations (80% on average) use rulings to increase tax certainty, especially private and binding rulings in the case of high and upper middle countries, while tax administrations from lower middle and low income countries registered more public rulings´ systems (Table 4).

Table 4. Rulings

	Rulings	Public Rulings		Private Rulings	
Countries	Total	Yes	Binding	Yes	Binding
TOTAL	80.8	64.0	50.4	69.6	60.0
High Income	89.6	64.6	50.0	85.4	77.1
Upper middle	81.8	63.6	54.5	63.6	57.6
Lower middle	73.9	65.2	47.8	60.9	43.5
Low Income	71.4	66.7	52.4	57.1	47.6

Source: ISORA (2015) and own elaboration

Finally, Table 5 shows the extensive use of special programs and segmentation policies to deal with the complexity of tax systems and to try to reduce it. In this case, the lower the income the greater the implementation of this strategy.

Summing up, improving tax payer service, easing cooperation channels and clarifying/simplifying legal framework are strategies already in place by tax administrations to increase tax certainty, even though to different extent depending somehow on the countries level of development. The measures proposed in the following section address some of these issues, but are not meant to be exhaustive. Additional initiatives are needed, for instance, in the realms of tax expenditure, tax competition and tax governance.

Table 5. Special regimes and segmentation policies

	Special regimes/segmentation		
Countries	LTO/program	SME	SMALL
TOTAL	84,8	40,8	54,4
High Income	72,9	33,3	35,4
Upper midlle	84,8	27,3	54,5
Lower middle	95,7	43,5	56,5
Low Income	100,0	76,2	95,2

NOTES: LTO: Large Taxpayers Office or program; SME: Small and medium enterprises specific programs; SMALL: Simplified income tax regime for small taxpayers

Source: ISORA (2015) and own elaboration

3 Proposals for increasing tax certainty

The main goals in terms of tax certainty should be to promote fair and effective mechanisms to increase certainty and create a climate of trust between Government and MNEs. Voluntary compliance based on mutual cooperation between tax administrations and taxpayers is a key element to increase bi-directional certainty in the complex area of controlling and clarifying tax obligations. Studies show that initiatives geared towards the promotion of voluntary compliance have generated positive results (OECD 2008, OECD 2013, CIAT 2015).

However, there is still a clear lack of relevant information on such initiatives, particularly on emerging and developing countries, and much work remains to be done to address concerns about the compatibility of such an approach with equality before the law. To do that, G20 can help to analyze, disseminate and improve current experiences, collaborating with the multilateral organizations that already have experience in this field (OECD, CIAT, ATAF, etc.).

In particular, the cooperative compliance initiative developed in the OECD Forum on tax administration would allow countries to reconcile their need for stable revenues with the desire to create a fiscal climate that encourages inward investment. Although the benefits of the initiative for developing countries seem to be clear, they are not yet sufficiently informed by practical experience.

Policy-oriented studies should be done on this topic, analyzing the results of these programmes, improving the organizational and technical capacity of domestic tax administrations to implement the different options, and reinforcing the compatibility between these new channels and the creation of a level playing field for all taxpayers.

About increasing tax certainty in countries beyond the G20, proactive and cost efficient solutions are required that help bridge the trust gap between Government and MNEs.

3.1 Short term recommendations

3.1.1 Enhanced Engagement Programmes

Enhanced Engagement Programmes (EEP) offer an opportunity to reconcile the goals of securing the tax base of countries with the need to create a more certain and transparent environment that encourages economic growth and investment, especially in a context of limited human and financial capacity.

If well implemented, these programmes can be a transparent, cost effective approach for both parties. The EEP would offer a platform and procedure for dialogues between large taxpayers and the tax administration. Their main objectives would be to overcome information asymmetries at an early stage, determine mutual obligations with regard to filing, reporting, controlling and auditing, and thus lower the costs of tax compliance and tax administration.

The EEP, by developing a robust relationship with large businesses based on mutual trust and transparency, would provide greater certainty to business through a cost-effective approach to dealing with tax matters, with speedy resolution of issues and clarity through effective engagement. The EEP would prioritise the most significant risks to deliver the most cost-effective way of getting the right tax agreed between both parties. From a perspective of applying such schemes to countries with limited state capacity and economic diversification, the EEP may be simpler and more practical in their application than fully-fledged cooperative compliance regimes.

Usually, the EEP would start to function before the filing of tax returns and other traditional compliance approaches, like audits and risk reviews. Under such programmes, MNEs willing to provide high levels of disclosure and transparency would discuss with the tax administration their high-risk transactions and be provided with the tax administration's views on the transactions. It is a collaborative approach that would take place before any audit, tax dispute and involvement of any tax tribunal.

The design of such programmes could vary, but common features would include:

- Pre-filing meetings
- Disclosure of high risk transactions
- High level of transparency
- Discussion of tax administration's and taxpayer's views on tax treatment of such transactions
- Non-binding views

EEP would be a chance for tax administrations in developing countries to focus on the most relevant MNEs in terms of tax revenue. Keeping the process as lean and straightforward as possible, a limited number of highly skilled tax officials with extensive industry knowledge could generate a better output by leading these programmes. As large businesses are extremely complex, understanding the business and the environment within which they operate is crucial to the success of the EEP. As such, the programme must be underpinned by systems that ensure taxpayer confidentiality to make sure that companies are willing to provide information that is commercially sensitive. The EEP would also require tax administration officials with in-depth knowledge of different tax regimes (e.g. corporation tax, VAT, employment taxes, etc.). Businesses would be grouped by sectors to offer an accurate picture of sectoral issues and apply the EEP approach consistently.

Large businesses that contribute a significant amount of tax revenue may be invited to participate in the EEP. Companies not selected by the tax administration to participate in the EEP but wish to do so would be invited to apply in writing. Their admission in the programme would be based on such criteria as their tax contribution to the fiscus, the complexity of their structure and operations, and their willingness to commit resources to engage the tax administration in the EEP.

As tax administration skills are being developed domestically, countries can consider secondments from other countries which have successfully implemented EEP programmes, or can make use of the Tax Inspectors without Borders (TIWB) programme to form part of the tax administrations' EEP teams. EEP handbooks or practical guidelines (by industry) could be developed to guide developing countries in the implementation process. This would be particularly important to ensure that the required case-specific confidentiality is embedded in a clear and transparent regulatory and procedural framework, in order to prevent collusion or other forms of illicit behaviour (e.g. aggressive tax planning, treaty shopping).

When the EEP is based on such rules and proven to be successful, the tax administration could even agree to close the tax return for a particular year or specific periods from further review or audit or any other compliance activities, thus reinforcing tax certainty. In the case of high tax risks, the tax administration may further develop strategies in consultation with businesses to mitigate the risk. However, such programmes would provide that if a taxpayer has not made a full and true disclosure of material risks or the tax administration considers that there is fraud or evasion, it would have the statutory right and compulsory obligation to re-open closed years for audit.

3.1.2 Development of suggested approaches to drafting legislation

Additional proposed solutions to increase certainty and create a climate of trust between Government and MNEs would include a development of suggested approaches to drafting legislation, for example around transfer pricing, interest deductibility, permanent establishment and mandatory disclosure rules.

These tools assist countries in drafting more effective legislation based on international standards and best practices, but adapted to include alternative policy options to address the specific challenges faced by developing countries. Regional tax organisations have already taken steps in developing such tools. These include for example the *Suggested Approach to Drafting Transfer Pricing Legislation*, the African Model Agreement for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income developed by ATAF.

Cross border transactions by multinational enterprises raise both the risk of double taxation for the taxpayer and double non-taxation for governments. Addressing these issues which can lead to uncertainty for both taxpayers and governments is highly complex. It is therefore crucial that domestic tax legislation and Double Tax Treaties are drafted in a manner that is clear and transparent. Most developed countries based their domestic tax legislation relating to international tax matters and tax treaties on the global standards set by the OECD. The constant implementation of such standards helps to provide consistency across jurisdictions and more certainty. However, applying these standards is often very complex and challenging for tax administrations in developing countries that have limited capacity.

Many developing countries have reported that they found it extremely difficult to apply the arm's length principle. Applying a different standard would significantly increase the risk of double taxation. The approach that ATAF has adopted in its *Suggested Approach to Drafting Transfer Pricing Legislation* is therefore based on the framework of the arm's length principle but includes alternative policy options that provide some more simplified approaches to meet some of the specific challenges faced by African countries. This includes provisions to address such issues as royalty payments and pricing of commodities.

ATAF is currently developing a Suggested *Approach to Drafting Interest Deductibility Legislation* and further tools will follow including a *Suggested Approach to Drafting Permanent Establishment Legislation.* Tax administrations in Africa are reporting that they are finding such tools to be very valuable in drafting new domestic legislation.

In the American area, we find other initiatives to coordinate and facilitate legislation drafting, like the CIAT Manual on Tax Collection and Recovery (2016) – that serves as a basis for proposing regulatory reforms and as a reference guide on collection and recovery, following the best practices based on the experiences of tax administrations in Latin America – or the CIAT Model Code of Conduct –a tool to assist in the development and implementation of a code of Conduct, adaptable to particular circumstances and country-specific legislative requirements.

However, the technical solutions the tools provide can only be effective if the new legislation is enacted swiftly. This requires political support for the changes to be implemented, support which is not always granted for a variety of reasons. More work needs to be done to obtain that political support and raise political awareness of the importance of these issues.

The G20 should cooperate with regional initiatives to increase its advocacy work so that these tools which provide a common, yet sufficiently flexible, framework for tax certainty that would be applicable in a broad range of countries have the political support to be swiftly enacted.

3.1.3 Align domestic rules with international standards and bilateral treaties

Aligning domestic rules with international standards and bilateral treaties to increase simplicity and transparency for both MNES and governments includes for example drafting permanent establishment rules in line with the revised wording of Article 5 of the OECD Model Double Taxation Convention. This will provide both tax administrations and taxpayers with certainty on when a foreign enterprise's business activities in a country constitute a permanent establishment and create a taxable presence in the source country. In the context of Africa for example, countries receive bilateral assistance in this matter through ATAF's country programmes and ATAF will be developing a *Suggested Approach to Drafting Permanent Establishment Legislation* for its member countries.

Other tools assisting developing countries in drafting legislations that respond to their needs while adhering to international standards include the Tax Code Model and the Model Agreement on the Exchange of Tax Information developed by CIAT. The first one offers a standard for an efficient and coordinated legislation while the second promotes and facilitates the exchange of tax information among the tax administrations of different countries (upon request, spontaneous or automatic) as well as provisions for joint tax audits. Its African equivalent is the ATAF Agreement on Mutual Assistance in Tax Matters (AMATM).

Countries will also need to consider introducing new provisions in their Double Tax Agreements to address treaty shopping and other forms of treaty abuse as well as introducing domestic anti-abuse legislation where appropriate. This will align both their bilateral treaties and domestic legislation to international standards.

The G20 should support such regional initiatives that align bilateral treaties and domestic legislation to international good practices, with a view on implementing international agreements that seek to improve tax certainty.

3.1.4 Using the country-by-country-report as an indicator for the adequacy of tax payments

A first assessment of the adequacy of an MNE's tax payment can be made by looking at the Country-by-Country Report (CbCR) elaborated by the OECD in its initiative against Base Erosion and Profit Shifting (BEPS). The rough estimation is based on detailed financial figures such as turnover, profit before tax, number of employees, taxes paid and taxes accrued separated by each member state. This does not mean that no further investigation is needed. The arm's length principle remains the global standard for the taxation of controlled transactions (i.e. transactions between related parties). The purpose of gathering all the information is to show the full picture of a company's global activities and tax burden. By applying the CbCR to MNE groups with a consolidated turnover of more than 750 million Euro, approximately 90 percent of corporate revenues are considered according to the OECD (2015, 21–23).

While the OECD intends to restrict the CbCR to the tax authorities, the European Commission is in favour of publishing the report (European Commission, 2016a, 10–11). In terms of tax certainty the impact of the two approaches is ambiguous. MNEs wold certainly prefer to discuss their figures exclusively with the tax auditors. For the tax administrations, it makes no difference whether the report is published or nor. An open access might reveal drawbacks in terms of competitive strength of the MNE and disproportional claims by the public as the appropriate taxation is rather complex. Thus, in favour of more tax certainty the access to the CbCR should be restricted to the tax authorities as indicated by G20 and OECD.

3.1.5 Setting up investment incentives to attract MNEs and to stabilize tax revenue

In a globalized world, foreign MNEs are key for boosting the economic development. Therefore, governments should try to attract foreign direct investment. Empirical evidence reveals that even in the presence of profit shifting and tax avoidance, MNEs contribute more to the national tax revenue than local companies. According to data for Germany, there is a statistically significant positive correlation between the international exposure of a company and its tax payment. An additional 1 per cent in foreign trade volume corresponds to an additional 0.2 to 0.4 per cent of corporate tax revenue. For foreign direct investment and corporate tax revenue the value is between 0.01 and 0.06 per cent (Hentze, 2015, 53–55). Thus, a trade-off between revenue stabilization and investment incentives does not necessarily exist.

These findings do not suggest that profit shifting can be neglected. It can be rather derived from the results that a climate of trust including smart investment incentives is both in the interest of MNEs as well as governments. Policy-makers should keep this in mind when thinking about a more restrictive regulation due to profit shifting activities.

The governmental focus should be on an undistorted investment climate. Key elements in this regard are an equal treatment of debt and equity for financing investments and favourable deduction rules. A reliable tax system does not mean to set up preferential tax regimes, tax loopholes or dumping tax rates. Any tax discounts, e.g. patent boxes, as well as individual tax deals should be prevented by the G20 and other supranational institutions. The strategy of taxing profits derived from trademarks and patents at a lower rate aims at attracting intangible assets for which location factors such as infrastructure and skilled work are of minor importance. The OECD and the EU try to restrict these tax discounts by proposing the "nexus approach", whereby the tax rebate is only granted if research and development actually takes place in the country. However, further steps are needed.

The tax discrimination of equity financed investments is supposed to be an obstacle for business activities. While borrowing costs are tax deductible, imputed equity expenses are not. Companies with a higher debt ratio generally face higher solvency risks and corresponding risk premiums for interest rates. The debt bias especially limits the dynamic and growth opportunities of start-ups since they face more difficulties to receive loans. To correct this imbalance, the same deduction rules for debt could be granted for equity or the deductibility of interests could be constrained. While the former approach would be rather in favour of fostering private investment, the latter one could stabilize the tax revenue at least in the short run.

Besides these structural aspects, tax rates play an important role in terms of a country's attractiveness even if they are not the most relevant factor for investment decisions. Due to accounting and tax rules there is often a substantial gap between the nominal and the effective tax rate. While the effective tax rate ultimately defines the tax liability, the nominal rate indicates if a country is rather a high or low tax jurisdiction. However, the nominal rate is often taken as a first indicator for the tax burden. Therefore, the nominal tax rate should be chosen with caution. Restricting tax deductions would close the gap between the nominal and effective tax rate. A minimum effective taxation should be guaranteed in order to prevent any harmful tax competition.

A further harmonization of international tax rules and a better cooperation between national tax authorities should therefore be enforced. The project against Base Erosion and Profit Shifting (BEPS) as well as the automatic exchange of information in tax matters reflect a substantial progress in this regard. The G20 should enlarge the pressure on tax havens to set the corporate tax rates to a minimum level. From an economic perspective, it can be recommended to create a rather straightforward tax system instead of complex tax loopholes.

3.2 Long term vision

3.2.1 Changing the international transfer pricing scheme

The main drawback of the current international tax scheme relates to the proper identification of the created added value in a global value chain of an MNE. The arm's length principle might lead to an inadequate allocation of profits within an MNE. It seems easy to manipulate taxable profits and to relocate them by sophisticated tax planning measures.

A promising long term approach in this regard might be a radical change of the international transfer pricing scheme to a unitary taxation system by applying the formulary apportionment method. The stimulation of fair tax competition and economic growth should be the main goal when modifying the tax regime. This would abolish the arm’s length principle as the main pillar of the current transfer pricing scheme and replace it by a different understanding of added value. Profits would be allocated according to economic activity for example in terms of revenues, number of employees and capital invested. The importance of intangible assets for tax matters would be significantly lowered.

The profit split method could ensure that MNEs pay their fair share in each country they are active in. The destination country of goods and services would be strengthened. Thus, parts of the global tax base would be shifted from the industrialized countries to emerging and developing countries. Recently, the European Union has set up a plan to implement such a system based on a common consolidated corporate tax base (CCCTB) in its member states (European Commission, 2016b).

However, there are reasons for refusing profit splits as most tax authorities do. In terms of tax certainty for MNEs, profit splits can only work when all countries involved accept the determined profit allocation and have common accounting standards. Otherwise, double taxation (or non-taxation) might occur (OECD, 2017, 39–42). From an economic point of view, it is questionable if any profit split methods are more convincing than relying on (hypothetical) market prices as in the current system. However, since the determination of (hypothetical) market prices lack sustainable results especially in the digital economy, a radical reform might be reasonable.

3.2.2 Taxation of the digital economy

The digitalization of businesses and value chains becomes more and more relevant for the international tax scheme. The profits of industrial companies and other companies in traditional industries are on average 21 to 23 percent taxed in Europe, while digital companies pay no more than 10 percent. Governments have no chance to levy corporate taxes if there is no physical presence in the country. In this case, even a profit split would not be a reasonable tool since there is no taxpayer to whom a tax base could be attributed. This might result in a non-taxation of a profitable operating business even if the sales numbers are significant. Therefore, the existence of a virtual permanent establishment should be defined.

Two tax policy instruments should be evaluated by the G20. Firstly, the value-added tax is an important instrument to guarantee at least a minimum of tax revenue. Secondly, a small withholding tax on the local sales could be raised on this type of business if there is no way to access global profits, for example as a mark-up on the value-added tax. Indeed, such a withholding tax should only be considered as a corporation tax credit and therefore work as a minimum taxation. Otherwise it could infringe WTO arrangements due to double taxation and would increase the tax burden for a specific group of companies resulting in augmenting distortions in the international markets. Additionally, if the company is not profitable, the risk of taxing the capital substance should be avoided. Private investments would be at risk. In particular, this holds for many countries against the background of the current tax cut in the United States which significantly improves the attractiveness of the United States as a location for investments.

4 Concluding remarks

With regard to the short term proposals, precise recommendations for strengthening tax certainty can be made: For the first policy proposal, implementation would require work on common standards (handbooks, practical guidelines) and the organisation of workshops to guide countries in the implementation of EEPs. For the second proposal, inter-regional workshops on legislative action would be needed for the upscaling of existing initiatives. G20 countries need to increase their advocacy work with Ministries of Finance in developing countries to ensure political support for this legislative action. For the third proposal, additional efforts in international assistance led by G20 countries are required to support governments in their efforts of implementing new standards and regulations. For the fourth proposal, the CbCR should be strengthened by the G20 to become a worldwide standard. For the fifth proposal, the G20 should encourage policy-makers to work on unbiased tax systems to stimulate investments, implying financial neutrality for investment decisions and favourable depreciation rules but also a minimum taxation.

In the long run, a radical change by repealing the arm's length principle and introducing a global formulary apportionment could be desirable in terms of tax certainty for governments and MNEs especially against the background of the ongoing digitalization.

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