

# Editorial

## *Tax Systems Twenty-Five Years from Now*

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How will the tax systems around the world look in twenty-five years? This intriguing question was raised by the 75 year young International Fiscal Association in a Jubilee Seminar at its 2013 Congress in Copenhagen, last August.<sup>1</sup> A panel from the six continents, chaired by Michael Lang (Austria) and including Wei Cui (People's Republic of China), Keith Engel (South Africa), Liselott Kana (Chile), Rick Krever (Australia), Scott Wilkie (Canada), took the challenge by going into five issues: the future development of the 'tax mix', the characteristics of Value Added Tax (VAT) systems, the arm's length principle, the introduction of new types of taxes and the relation between tax administrations and tax advisors. After each agenda point the audience could share their opinion by voting on the predicted developments. Although the five issues were discussed in the above mentioned order, I will first go into the arm's length principle and the relation between tax administrations and tax advisors.

As regards *the future of the arm's length principle* – an evergreen in the field of profit taxes – the panel predicted the continuation of this principle in many countries which adhere to the OECD standards. In Asia, however, where many countries do not yet have sufficient experience with transfer pricing issues, the future for this principle is less certain, whereas in the Latin American region a parallel development of formulary apportionment cannot be excluded. Whether or when a formulary apportionment CCCTB system will be introduced in the EU was considered to be unclear. Voting on the question whether the arm's length principle, as it is typically understood today, would survive the next twenty-five years, only half of the audience replied in the affirmative. I would like to add that, if the role of the arm's length principle would be reduced by the introduction of formulary apportionment systems, the disputes in the arena of international

taxation will shift from transfer pricing to 'the formula' and the elements of such a formula.

As regards *the relation between tax administrations and tax advisors*, the panel signalled a substantial divergence worldwide. Although there are still regions where that relation is problematic, often because of mutual distrust and disparities in skills, in many countries the relationship between tax administrations and taxpayers is improving as a result of more private input, less adversarial interactions, more automatic control mechanisms and more transparency. Nevertheless, the increase of anti-avoidance legislation and initiatives against aggressive tax planning lead to a focus on detecting and combating abuse and evasion, mainly with the help of automatic data collection, cross-checking and exchange of information between tax authorities. Moreover, and in particular in countries with serious budgetary problems, there is pressure on tax authorities to raise more revenues. The panel expected a change in the role of tax advisors moving to more specializations required for working with increasing complex legislation. The majority of the audience showed its optimism by voting for the statement that the relationship between tax administrations and taxpayers would become more cooperative in the future. Surprisingly, the discussion on this agenda point did not go into the impact of the tax mix on this issue, whereas direct and indirect taxes have different impact on the relation between tax administrations and taxpayers.

In the first agenda item, dealing with *the development of the 'tax mix'*, the panel went into the question whether it is inevitable that the existing trend of a shift from direct taxes to indirect taxes, in particular VAT<sup>2</sup>, will go on in the next twenty-five years. VAT, applied as general consumption tax in more than 150 countries, appears to be a robust revenue raiser taking about 31% of tax revenues in OECD countries (the US is the only OECD member country without a VAT) and about 20% worldwide. As regards *the characteristics of VAT systems* (the second agenda point), the panel pointed at the great diversity among the implementation of VAT systems around the world; even within the harmonized VAT

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<sup>1</sup> A summary of the discussion has been published in Tax News Service on the website of IBFD (IFA's sister organization). See also [http://online.ibfd.org/data/tns/docs/html/tns\\_2013-08-28\\_ifa\\_2.html?WT.z\\_nav=crosslinks#tns\\_2013-08-28\\_ifa\\_2](http://online.ibfd.org/data/tns/docs/html/tns_2013-08-28_ifa_2.html?WT.z_nav=crosslinks#tns_2013-08-28_ifa_2).

<sup>2</sup> Also referred to as Goods and Service Tax (GST).

system in the EU uniformity in VAT rates and exemptions is lacking. The vast majority of the audience expects that the diversity will remain. Back to the 'tax mix', in a number of countries (especially in the Latin American and Asian regions) consumption taxes play a more significant role than income taxes. In general, as a result of the financial crisis, governments tend to increase VAT rates or broadening the tax base for VAT, the more so as increasing tax competition leads to a decline of corporate tax rates. The panel, pointing at the regressive nature of VAT, expected that politicians would be hesitating to further increase VAT rates. Also the majority of the audience was of the opinion that a further shift toward indirect taxes is not inevitable. This conclusion is remarkable if we look at the conclusion on the fourth agenda item dealing with the introduction of *new types of taxes*. The majority of the audience expected the implementation of significant new taxes in the future, but most of those new taxes will probably be indirect taxes. Although in Australia and the US the introduction of new taxes is considered to be unlikely, in the EU and Asia we may expect an increase of environmental taxes (mainly indirect taxes, including

excises on fossil fuels) and taxes on financial transactions (also indirect taxation), because they are considered to be robust and politically well-defendable additional tax sources.

In the discussion on the tax mix I missed one relevant element, i.e., the notion of 'indirect tax'. Obviously the discussion was based upon the traditional distinction between direct taxes (on income) and indirect taxes (on consumption and transactions). In many countries, however, also taxes (and social premiums) on labour income (wages) are levied indirectly as a withholding tax. This means that the greatest part of total tax revenues is collected through 'third parties': taxable persons who do not bear the tax themselves.<sup>3</sup> So only a relatively small part of the tax mix is more sensitive to (aggressive) tax planning, base erosion and profit shifting which have direct impact on the relation between the tax authorities and the taxpayers. A further shift to indirect taxes in the sense of taxes collected through entities who do not bear the tax themselves could make the tax mix more robust and less vulnerable to 'BEPS'. Therefore I would not be surprised if the next twenty-five years will show a further shift to indirect taxes collected through 'third parties'.

<sup>3</sup> For instance in The Netherlands, about 93% of total tax revenues is raised by consumption taxes and wage taxes (including social premiums).