Foreign investors look for tax certainty, rather than tax incentives, says Ms. Navarro

Countries across the world are coordinating to prevent tax evasion by multinational companies (MNCs) and also to exchange information about secret bank accounts of tax evaders. Government of India is working with more than 135 countries under the aegis of OECD and G20 forum to adopt a uniform tax regime for multinational companies. Such a uniform tax regime across borders is beneficial for both governments as well as MNCs. Governments across countries benefit through increase in their tax revenue as they coordinate their action to prevent tax evasive strategies of MNCs. It is estimated that governments across the world are losing tax revenue worth USD 100-240 billion because of the strategy of MNCs to shift profits from high tax countries to low tax countries. On the other hand, MNCs benefit from the tax certainty and uniformity that this coordinated efforts brings across jurisdictions.

Government of India is also working with 160 countries, including the members of OECD to exchange information on secret bank accounts of potential tax evaders in foreign countries. As a result of this initiative, bank deposits in international financial centres (IFCs) have fallen by approximately 34%.

In an interview to MVIRDC World Trade Center Mumbai, Ms. Grace Perez-Navarro, Deputy Director, OECD Centre for Tax Policy and Administration shares information on how India and other countries have benefitted from this coordinated efforts.

In order to attract foreign investment, Ms. Navarro suggests Government of India to provide tax certainty and effective dispute prevention & dispute resolution mechanisms, rather than offering tax incentives that complicates tax system.

Excerpts of the interview:

1. Explain us the work of OECD on Inclusive Framework on BEPS and how can countries such as India can benefit from this initiative?

India has played a key role in the development of the work to tackle base erosion and profit shifting (BEPS) by multinationals from its inception in 2013. India worked with all OECD and G20 countries to develop the BEPS package of 15 measures to tackle tax avoidance, which restore the link between tax and substance, improve the coherence of international tax rules and ensure a more transparent tax environment. This work, and its implementation, continues today through the efforts of the more than 135 members of the Inclusive Framework on BEPS.

BEPS behaviours have been estimated to cost governments anywhere between USD 100-240 billion a year. Since BEPS implementation began in a co-ordinated and consistent manner, such BEPS practices have been harder for MNEs to undertake. For example, India now receives the spontaneous exchange of rulings from other countries that may impact its revenues. It also receives Country by Country reports from over 70 jurisdictions, an important risk assessment tool that allows its tax administration to better focus its efforts to counter BEPS behaviours as a result of the increased transparency of MNEs' activities resulting from these reports. The benefits of BEPS implementation for businesses are also clear, as there is increased tax certainty resulting from the peer review of its Mutual Agreement Procedure processes. This has helped ensure that double taxation is minimised and that tax disputes between India and other countries are resolved in a timely, efficient and effective manner.

India is also actively participating in the ongoing negotiations of the two-pillar project to address the tax challenges arising from the digitalisation of the economy. Pillar 1 aims to establish new nexus and profit allocation rules, whereas Pillar 2 aims to ensure that MNEs pay a minimum level of tax. The design of both pillars reflects consultation with businesses and other stakeholders. Without a global solution, the counterfactual may be a proliferation of uncoordinated, unilateral digital services taxes (DST) or other measures targeted at digital activities, leading to trade tensions at a time when the global economy is under a strain not seen since the Great Depression. We are already seeing the trade tensions rise with the announcement this week by the US Trade Representative of the initiation of section 301 investigations of the digital services taxes of India as well as Austria, Brazil, the Czech Republic, the European Union, Indonesia, Italy, Spain, Turkey, and the United Kingdom.

2. The Global Forum on Transparency and Exchange of Information has been active since 2000 to eliminate banking secrecy. How has countries such as India benefited from this initiative?

India is an active member of the Global Forum, which ensures the effective implementation of the international tax transparency standards. The over 160 members of the Global Forum are implementing these standards and already more than 100 have begun to automatically exchange information on financial accounts, paving a solid path to the elimination of bank secrecy. This work has resulted in information on over 50 million accounts being shared worldwide in 2018, worth some 5 trillion Euros. Around 102 billion of tax have been identified for collection as a result of this work and are in the process of being collected. Moreover, our research shows that bank deposits in international financial centres (IFCs) have fallen by approximately 34% over the past ten years for a decline of USD 551 billion. A large part of that decline is due to the onset of the automatic exchange of information, which accounts for about two thirds of that decrease. Specifically, automatic exchange of information (AEOI) has led to a decline of 20% to 25% in the bank deposits in IFCs over the past decade.

Beyond the automatic sharing of banking information, the robust peer review processes of the Global Forum of the exchange of information on request standard, and the upcoming reviews of the automatic exchange of information standard, ensure that there is nowhere left to hide for tax evaders. All relevant jurisdictions around the world, including all no or low tax jurisdictions, are reviewed and held to high standards of transparency including with respect to beneficial ownership of legal entities and maintaining reliable books and records. The international transparency standards continue to evolve and India plays a key role in their development.

3. Several countries, Including India, have provided tax reliefs to businesses to tide over the COVD crisis. Some countries such as Peru are discussing to raise fiscal resources through wealth tax. Given the fiscal constraints faced by India, what are your tax policy suggestions to Government of India to manage the current crisis?

India has taken a number of measures to immediately respond to the economic crisis caused by COVID-19. Such measures include extending the deadline for tax filing and implementing, as well as more flexible tax debt repayments, both of which are welcomed by taxpayers. In general, the first priority of governments should be to help businesses and households in order to restart the economy. This implies that the measures taken during the crisis that have allowed businesses and households to stay afloat should continue until the economy has fully restarted.

It would also be wise to exercise caution when introducing tax rate cuts or base narrowing measures. Such measures might not be effective if households start spending anyway and businesses take up their normal activity irrespective of receiving tax-related support. In this case, such tax rates cuts or base narrowing measures could come at a very large revenue cost to the detriment of the national budget.

Additional measures that could help restart economies include allowing for accelerated tax depreciation allowances or immediate expensing for new investment. These measures could be introduced for a few years to induce firms to invest today rather than to wait until later. Governments should refrain from measures that come at a large budgetary cost and that will not have a large impact on investment and consumption, such as temporary VAT rate cuts.

At this point, it is too early to start discussions on fiscal consolidation measures (i.e. tax rate increases), although Ministries of Finance could start considering the options. Nevertheless, fiscal consolidation measures should not be introduced too quickly, as the first priority is to get the economy restarted. Once it is an appropriate time to begin considering fiscal consolidation measures, any such measure should be aligned with good tax policy design. Furthermore, fiscal consolidation measures should come with a revenue gain that is sufficiently large to signal that the tax increase will indeed be temporary in order to maintain confidence in the financial markets and economy.

4. What are the tax reforms you suggest Government of India to attract multinational companies that are looking to diversify their supply chain from China in the post-COVID world?

Designing a transparent, business-friendly tax system is the best approach to attract foreign direct investment and stimulate domestic investment. Setting effective tax rates at a reasonable rate, broadening the base and providing tax certainty through effective dispute prevention and dispute resolution mechanisms could help contribute to a favourable tax environment for potential investors. Businesses around the world have stressed the importance of tax certainty in their investment decisions. Any tax reform that is implemented in response to the Covid-19 crisis in particular should follow best practices in tax policy design. This means that introducing additional tax incentives to attract investment is very likely to be inefficient. Instead, government should continue creating an attractive and business-friendly environment for investment rather than introducing more tax incentives that make the tax system even more complex and force the government to make choices about what type of activity to subsidise thereby creating winners and losers.

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