



SCHOOL OF HISTORICAL, POLITICAL AND SOCIOLOGICAL STUDIES
Department of Politics

***THE CHANGING GOVERNANCE ARCHITECTURE
OF INTERNATIONAL AND EU TAXATION***

CODE NAME: TAXGOV

GENERAL PROJECT DESCRIPTION

Project Team:

Claudio M. Radaelli
Ulrike Sabrina Kraemer
Exeter University, UK

C.Radaelli@ex.ac.uk

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FRAMEWORK SIX PROJECT ON NEW MODES OF GOVERNANCE***

AIMS

The aims in this project are to produce original research on international tax policy, assess new proposals for the future direct tax policy of the European Union and the wider issue of ‘good global tax governance’, and engage in dissemination activities.

One important aim in TAXGOV is to examine new modes of governance in the direct tax policy of the European Union (EU). The project will discuss the emergence, efficiency, evolution, and legitimacy of innovative tax policy instruments and modes of governance. One example is the EU code of conduct in business taxation – an instrument of the EU Council to limit and roll-back harmful tax regimes in Member States and their controlled territories.

CONTEXTUALISING NEW TAX GOVERNANCE

Our analysis of new modes of tax governance will be contextualised in four directions. Firstly, new modes of governance will be analyzed in the context of their dynamic interaction with ‘old’ modes of governance. Let us take the example of the EU code of conduct in business taxation. The code of conduct will not be examined *in vitro*, but in relation to (a) the new regime for the taxation of EU residents’ savings deposited in other EU Member States, (b) the fiscal components of EU state aid policy, (c) recent ECJ jurisprudence on tax matters, and (d) existing domestic tax laws currently not targeted by the code, specifically fiscal incentives available to corporations and individuals.

Secondly, the efficiency and legitimacy of new tax governance in the EU will be examined in relation to the OECD initiatives against harmful tax practices, which cover both classical tax havens and potentially harmful tax regimes of OECD members.

Thirdly, the team will assess the potential of new modes of tax governance as Europeanisation. OECD and EU tax policy will be put in the context of their influence on domestic tax policies.

Fourthly, the project will contribute to the horizontal analysis of key issues in the EUI project, such as policy learning in a political context and the potential of the open method of coordination as ‘new governance’ (team led by Ulrika Morth and Brigid Laffan). It could also link into the EUI project teams on corporate governance, economic policy, and on OMC/WTO. We see a high potential for integrating TAXGOV with the EUI project specialists in political theory as we will address questions related to the public interest in international taxation and the criteria for ‘good governance’ in the emerging ‘global tax order’.

ASSESSING THE QUALITY OF TAX GOVERNANCE

One key aim in this project is explanation. But another is to assess new governance in terms of legitimacy and efficiency. The project will make explicit proposals for ‘better global tax governance’, illustrate the steps to reach it, and analyze the impact of specific instruments.

The project will be *critical and forward-looking*. The EU and OECD initiatives to deal with harmful tax competition have attempted to counter some of the problems but have ignored others. TAXGOV will argue for a comprehensive approach, arising out of four basic yet often neglected questions:

- * what are the problems?
- * what are the possible actions that might be taken?
- * what instruments are available to implement those actions?
- * which are the appropriate institutions to take such actions?

The term tax competition has been applied to three quite distinct ‘problems’:

(a) competition for FDI of a substantial nature (i.e. manufacturing) by offering unusually low tax rates or special incentives (e.g. tax holidays);

(b) provision of special “preferential tax regimes” for the establishment of MNE “centres” – for activities such as the provision of group financial services;

(c) establishment of tax havens.

These three practices serve different functions: type (a) may be classified as tax reduction, type (b) as tax avoidance, and type (c) primarily as tax evasion. Types (a) and (b) are targeted towards MNEs, whereas type (c) principally facilitates evasion by individuals, although the definition of tax havens and who uses them is contested in the literature and in the political debate.

Different types of action require different instruments. The EU already possesses instruments that can be employed to eliminate harmful practices of its own members – the Treaty rules, directives, code of conduct, etc. Although the OECD does not have similar legally-enforceable instruments, agreements, resolutions and peer-pressure have proved fairly effective in the past. More problematic is what to do about the harmful practices of non-members. A stick-and-carrot approach seems appropriate, but it remains to identify the types of sticks and carrots that can be employed. These might include the re-negotiation of tax treaties, the withdrawal of tax sparing privileges, the extension of CFC (controlled foreign company) rules, deemed residence rules, restrictions on bank dealings with black-listed jurisdictions, withdrawal of trade preferences, etc. The question also arises whether individual countries that feel threatened by tax competition should be left to take action unilaterally, or whether such action needs to be coordinated in some way.

Thus, the project will not be focused exclusively on harmful tax competition. Quite the opposite, it will focus on measures for improving coordination. It will investigate methods for building on the measures adopted so far in the EU and the OECD's initiative against harmful tax competition, by new governance mechanisms which could improve coordination both of formulation of tax measures (especially definition of the tax base), and tax administration (ranging from information exchange to joint examination of related entities), as well as more radical alternatives (e.g. ‘home state taxation’ and unitary taxation). These are increasingly urgent as requirements for integrated markets are leading to invalidation of traditional national-based measures (see recent ECJ decisions on controlled foreign corporations, and the WTO decision against the US foreign sales corporation).

RESEARCH QUESTIONS

Research questions related to explanation:

- Classification of new modes of tax governance in relation to types of tax policy problems
- How did new instruments come about? When? Why? Why were other alternatives silenced in the debate? Why did policy-makers not consider them?
- What is the relation between new tax instruments and the open method of coordination?
- What are the key mechanisms at work in the OECD and EU new modes of governance? To what extent do these mechanisms draw on learning, political threat, and (in the case of the EU) old governance? What do new modes of tax governance tell us about learning in a political context? Who (policy-makers, institutions,) learns what? What is the (un-exploited?) scope for social learning?

Research questions related to assessment:

- Is new governance efficient in EU direct tax policy? Has it reached its goals? Has it produced major change of domestic tax policy?
- What has been achieved by new modes of governance in the EU and the OECD so far? Do we see a set of shared beliefs (perhaps a new tax policy paradigm) among European tax policy-makers, or do beliefs remain ultimately different? We will make a distinction between convergence at the level of ideas and vocabulary, convergence of core policy beliefs, convergence at the level of decisions, and convergence at the level of impacts.
- More fundamentally, are the EU and OECD instruments tackling the real issues? If not, what needs to be done in the direction of a comprehensive approach?
- What is the implicit definition of the public interest in new governance?
- What is the most appropriate set of criteria for the design of better international tax governance?

INNOVATION-RELATED ACTIVITIES

The project will organise a number of dissemination events. Dissemination is a priority in this project. We plan specific dissemination events for the Institute of Fiscal Studies, chartered accountants, the community of international tax lawyers (with special events organised under the aegis of the International Fiscal Association and its national branches). We will offer specific briefings to the European Commission and the Council group working on the code of conduct in business taxation.

DURATION OF THE PROJECT

The project will last three years, but we see the third year as an opportunity to develop the integration of TAXGOV with the other projects in our cluster and in NEWGOV in general. Hence we have budgeted RDT activities eminently for the first two years.

WORK IN PROGRESS

THE RISE AND FALL OF INFORMAL GOVERNANCE'S LEGITIMACY: THE CASE OF DIRECT TAXATION

Claudio Radaelli and Ulrike Kraemer

This paper covers the long-term development of informal governance in international and EU direct taxation. It makes two claims. Firstly, informal governance is 'old' governance as far as direct taxation is concerned. Evidence for this claim comes from the emergence of an epistemic community within the League of Nations before World War Two and the soft mechanisms used to diffuse principles of income taxation in the first part of the last century. Principles, rules, and instruments were then somewhat institutionalised by the OECD in the context of the model treaty convention and guidelines between the 1960s and the 1980s. The OECD approach – based on informal governance - was quite successful both in terms of diffusion and in terms of legitimacy. During these years, the European Commission tried to promote formal governance of direct tax policy, with ambitious plans for directives in the 1960s and 1970s, but no result was achieved. In 1990 two directives and one arbitration convention were approved. However, they covered only minimal aspects. The idea of a convention rather than a directive was not inspired by considerations on the legitimacy of informal governance. Instead, it was the result of the Council's opposition to binding directives in the area of transfer pricing.

In the 1990s, the OECD launched more ambitious and multilateral plans aimed at cracking down harmful tax practices in member states and in non-OECD jurisdictions. At the EU level, the fight against harmful tax competition provided the opportunity to 'discover' informal governance with the code of conduct on business taxation. The code, however, was nested in a tax package containing a directive on savings – a classic example of formal governance.

The second claim is about legitimacy. The legitimacy of informal tax governance has been declining over the last 100 years or so. There are several reasons for that, most importantly the scope of informal governance and the range of actors involved therein. The wider the scope and the range of actors targeted by informal governance, the larger the loss in legitimacy. This leads to the paradoxical conclusion that legitimacy has been higher under conditions of close, technocratic informal governance networks – a point hard to reconcile with democratic theory.

The final part of the paper will make some steps towards reconciliation by looking at the issues of 'legitimacy for whom' and at the notions of 'good governance' implied by different notions of legitimacy.

NEW GOVERNANCE IN EU DIRECT TAX POLICY? AN ASSESSMENT

Claudio M. Radaelli

Ulrike S. Kraemer

Over the next ten years or so, the EU has experimented with new tools for direct tax policy coordination. Most of them depart from the traditional Community method. The question arises do they provide an instance of new tax governance? If so, what are the strengths and limitations of new governance tools applied to this controversial policy area?

The paper will examine a number of recent initiatives that share the following characteristics. They are non-binding, fall outside the Community method, and use policy fora rather than classic institutional venues. Specifically, we will provide empirical analysis of the code of conduct against harmful tax competition, the transfer pricing forum of the European Commission, the initiatives for fundamental corporate tax reform, and the 2004 Communication of the Commission on taxation and corporate governance. We will then assess the initiatives in terms of their overall political coherence, and look at the following dimension: emergence, actors involved, how policy problems are defined, the rules of interaction, and the achievements so far. The final part of the paper will assess 'new governance' in EU direct taxation normatively, by using the principles of better regulation proposed by the Mandelkern Report – a typical benchmark for EU discussions on 'good regulatory governance'. The argument will be that there is limited coherence in terms of 'new governance' – political expediency rather than logic guided the choice of specific instruments. In terms of 'good governance', however, there is more variability – the code of conduct being the most problematic case.

WHO LEARNS WHAT? POLICY LEARNING IN THE CONTEXT OF THE OPEN METHOD OF COORDINATION

Claudio M. Radaelli

To be delivered to the ESRC seminar on the Lisbon strategy, Birmingham University, 26 November 2004.

<http://www.laws.qmul.ac.uk/lisbon>

SOFT LAW, NEW POLICY INSTRUMENTS AND MODES OF GOVERNANCE IN THE EUROPEAN UNION

Exploratory workshop with Brigid Laffan, Ulrika Morth, Claudio Radaelli, and Ulrike Kraemer, University of Exeter, 28 January 2005.