Introduction

Some Global Perspectives

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1. Introduction

Thank you Mr Chair for your kind introduction.
Ladies and gentlemen, good morning.

It is an honour and a pleasure to give this speech to open a very interesting and important conference organised by the Flemish Government for the Belgian Presidency of the EU.

I will share with you some global perspectives on the question of fiscal federalism. They are drawn from my personal involvement with the implementation of VAT, projects carried out on tax policy for the European Commission, my work for the OECD and PwC's decades of experience with fiscal reform globally[2].

As every year, PwC and the World Bank have published *Paying Taxes 2011. The Global Picture*[3].

As you can see in the figure below, in more than 100 countries globally, taxes are levied by two or more levels of government.

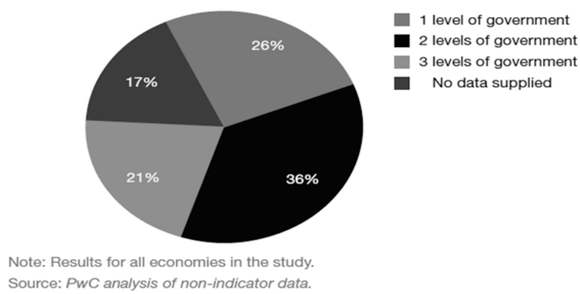

Figure 1: PwC Paying taxes 2011 – The levels of government that can levy taxes

Source: PricewaterhouseCoopers/World Bank Group – Paying Taxes 2011: the global picture

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2 PwC has used its experience in designing and implementing VAT systems and in reform programmes in 37 of 71 countries that have used external advisers around the world. PwC has delivered more than 20 studies on VAT to the European Commission. Many programmes also included reforms for other taxes.

3 *Paying Taxes 2011. The Global Picture* is a joint publication from the World Bank Group – International Finance Corporation and PricewaterhouseCoopers LLP, see www.pwc.com/gx/en/paying-taxes.

2. Designing Efficient Tax Systems

When designing the tax system in a federal country, as in any country the interests of three stakeholders have to be taken into account: the government, business and citizens.

At the outset, the overarching policy objectives should be defined.

A balance is needed among the objectives of the three stakeholders.

An effective, efficient tax system has to be able to cater for each party's interests equally. The government's aim is to increase its budget, allowing it to invest in the country (e.g. infrastructure, healthcare and education) and attract and retain business whilst creating new, and securing existing jobs. Businesses want to compete globally, delivering a sustainable profit without running risks due to not being able to comply with the tax rules. Citizens are looking for a fair tax that is not regressive or inflationary. Furthermore, they expect that revenue will be invested by the government to deliver long-term future benefits, such as social well-being (e.g. a high standard of living, education, medical services, roads,…) and jobs.

The use of technology will be key to ensuring that the costs of collection, enforcement and compliance are low (maximised "voluntary" compliance with minimum amounts spent on enforcement and collection by the government and minimum compliance costs for taxpayers)[4].

The aim should be to deliver a tax system that is a "*win-win*" for all parties involved, as illustrated in figure 2, below.

[4] **Singapore**: "*For the financial year ended 31 March 2010, the GST collected by the Inland Revenue Authority of Singapore ("IRAS") was $6.914 billion, which constitutes 23.15% of the total taxes of S$29.871 billion collected by the IRAS for the financial year.[1] The GST collections represent about 2.6% of the country's total GDP of S$265 billion[2] for the financial year ended 31 March 2009. The other taxes collected by the IRAS include income tax, property tax, stamp duty, estate duty and duties from betting, sweepstakes and private lotteries. The amount of GST collected by the IRAS excludes the amount of GST that is collected by the Singapore Customs authority on goods that are imported into Singapore. While there is no separate measurement for the cost of collecting GST, the average cost per dollar of tax collected by the IRAS has been kept at below one cent for a number of years. For the year ended 31 March 2010, the cost per dollar of tax collected was 0.88 cent (S$).*"[3]
Sources:
1 Annual Report 2009/10 Inland Revenue Authority of Singapore.
2 www.singstat.gov.sg/.
3 Annual Report 2009/10 Inland Revenue Authority of Singapore
Australia: "*The ATO's cost of collecting GST is approximately 1.46 percent of collections.*"
Source: Commissioner of Taxation, Annual Report 2008-2009, NAT 0995 (October 2009). The 1.46 percent figure is calculated from the reported A$602 million cost of collection (p. 133) as a percentage of the reported A$41.2 billion raised (page iv).

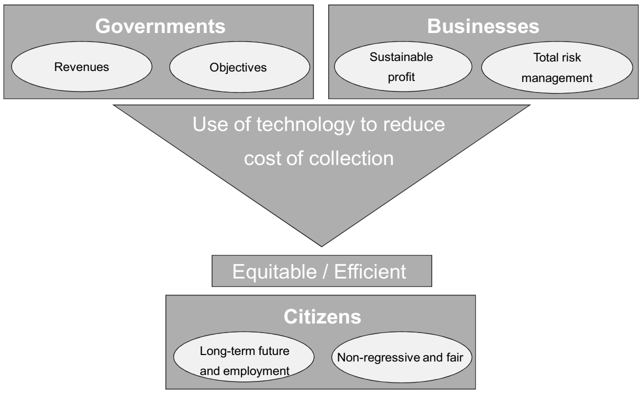

Figure 2: Designing efficient tax systems

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3. Which Tax is a Good Tax for a Region/Sub-National Entity? Global Trends and Experiences

One of the questions to be answered is: which tax is a "good" tax for a region or subnational entity? The OECD has performed an interesting study on this topic. It showed that a relationship exists between the tax mix and economic growth in relation to *per capita* GDP growth. The impact from taxes is as follows, from the least to the most distorting:

– immovable property tax;
– consumption taxes;
– personal income taxes;
– corporate income taxes.

Shifting the tax mix towards immovable property and consumption taxes enhances growth and is revenue-neutral[5]. This should also be borne in mind when selecting the tax to be levied by the region/sub-national entity.

As the authors indicate in this study, limiting the region's/sub-national entity's taxes to immovable property is not very popular, as it is a very visible tax and not liked by the general public (and, consequently, not by politicians, either).

Globally, we are seeing a shift from direct to indirect taxes.

As the result of global competition between countries, by creating a more-attractive tax environment for foreign investment, there is a gradual global trend toward declining income tax rates. Within the European Union, the average corporate income tax rate fell from more than 35% in 1995 to around 23% in 2010. In Japan, it went from more than 50% in 1995 to around 30% in 2010,

[5] OECD 2009, *Taxes and grants: on the revenue mix of sub-central governments*, H. BLÖCHLIGER and O. PETZOLD.

and a further reduction is expected in 2011[6]. The BRIC countries (Brazil, Russia, India and China) also reduced their corporate income tax rates from around 40% in 1995 to less than 30% in 2010. Figure 3, below, shows the downward trend in corporate income tax rates.

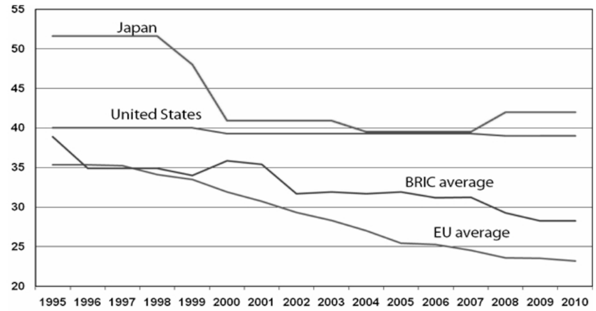

Figure 3: Global trend toward reducing corporate income tax rates

Source: EU Commission – Taxation Trends in the European Union, 2010 edition: http://ec.europa.eu/taxation_customs/taxation/gen_info/economic_analysis/tax_structures/index_en.htm

With it gaining in importance as a revenue generator, a number of governments are looking to increase the share of VAT as a proportion of total taxes collected. This means that VAT is increasing as a percentage of total taxation. For example, in the European countries within the OECD, VAT formed something over 17% of total tax revenue in 1985. In 2006, VAT revenues as a percentage of total taxation had already gone up to around 20%. Figure 4[7], below, shows that VAT is already forming a significant part of total taxation in the OECD countries.

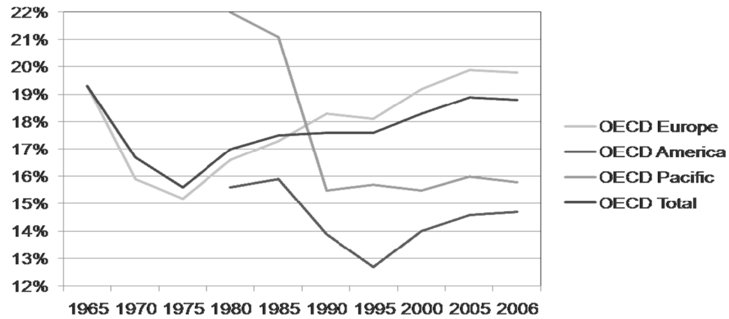

Figure 4: VAT as percentage of total taxation in OECD countries

Source: OECD Consumption Tax Trends, 2008 edition.

6 www.ibtimes.com/articles/29392/20100618/japan-corporate-tax-economic-growth-deflation.htm.

7 EU Commission, *Taxation trends in the European Union*, 2010 edition: http://ec.europa.eu/taxation_customs/taxation/gen_info/economic_analysis/tax_structures/index_en.htm.

Within the European Union, the VAT collected represents on average almost 7% of GDP (see figure 5) and this share has been increasing over the past years[8].

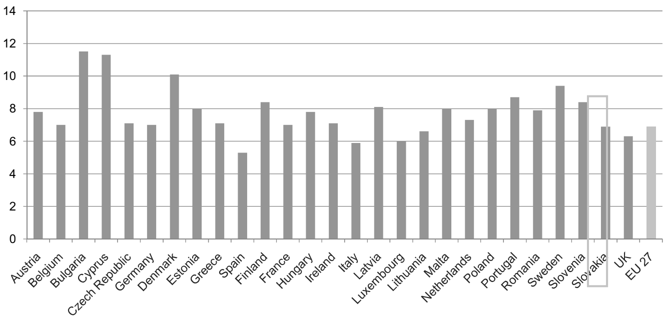

Figure 5: Which tax is a "good" tax for a region/sub-national entity?
Source: EU Commission - Taxation Trends in the European Union, 2010 Edition

4. Collection and Allocation of VAT Revenues – Examples

As VAT is such an important tax and has a positive impact on *per capita* income, it could be considered as a regional/sub-national entity's tax. Different models exist for collecting and allocating VAT revenues around the world.

In that case, of course, in the EU one should be compliant with the EU Treaty and the rules laid down in the VAT Directive and the implementing regulations[9].

Here are a few examples of how other countries deal with this issue.

In Australia, goods and services tax (GST) was introduced by federal law in 2000. GST is administered by the federal administration. All GST collected is fully distributed the states. The allocation is defined by the Commonwealth Grants Commission (CGC) further to specific criteria that are laid down in legislation[10].

In Belgium, VAT is enacted by federal law and also collected by the federal VAT administration. The distribution is defined annually in the so-called Financial Arrangements Act[11]. In 2007, the revenue (about EUR 24 billion) was distributed as follows:

- EUR 459 million to the EU;
- EUR 12.3 billion to the Communities;

8 Study on the feasibility of alternative methods for improving and simplifying the collection of VAT through the means of modern technologies and/or financial intermediaries (20 September 2010) http://ec.europa.eu/taxation_customs/common/consultations/tax/2010_11_future_vat_en.htm.

9 See Art. 99 of the Treaty of Rome and Title XI, Chapter 1, Section 2 of the Directive 2006/112/EC. See also Art. 273 of the above-mentioned Directive and the implementing Regulation COM(2009) 672 final.

10 See Commonwealth Grants Commission Act 1973 and Intergovernmental Agreement on Federal Financial Relations.

11 *Bijzondere Wet betreffende de Financiering van de Gemeenschappen en de Gewesten (16 januari 1989)" Titel IV – Toegewezen gedeelten van de opbrengst van belastingen.*

- EUR 190 million for the police forces;
- EUR 11.6 million to the Electricity and Gas Regulation Commission;
- EUR 9.7 billion as alternative financing for social security to the federal government;
- 3.4% of the total net VAT income () was retained by the federal government.

In Germany, personal income tax, corporate income tax and VAT are collected by the Federation (*Bund*), the states (*Länder*) and the Municipalities (*Gemeinden*)). The averts the trust issue between the levels of the governments in the country and shifts responsibility for enforcement onto the level within the country that should be ensuring collection of the most revenue. The redistribution was as follows in 2006[12]:

- 5.63% to the Federation to finance the social security pension scheme;
- 2.2% to the municipalities;
- the remainder: Federation 39.6%, *Länder* 44.9% and municipalities 2.0%.

In Canada, another federal country, a dual form of GST exists. It has two components: a federal GST and provincial retail sales taxes (PST). The latter can be administered separately, with the federal government managing GST and each province its own retail sales tax. Alternatively, a province can opt to "outsource" the management of sales tax to the federal level. In that case, they introduce harmonised sales tax. Furthermore, there exists a separate federal and provincial VAT that is administered provincially (QST), but only in Quebec. The revenue allocation is as follows:

- federal GST revenues remain with the federal government;
- HST: province receives the difference between the federal GST rate and the HST rate;
- provinces not participating in HST collect and retain their own sales tax revenue.

Finally, it will be interesting to follow the tax reform projects under way in two other federal countries. Both India and China are running reform programmes to change their VAT systems. India will move from federal VAT on supplies of goods and a service tax to an integrated GST system. The same is being undertaken in China, with it looking to integrate the federal VAT on goods with the business tax levied on services by the provinces. In both countries, a solution is needed to redistribute the collected VAT/GST to the different levels of government in the country.

What is important in those cases is to avoid resolving allocation of the revenues collected by having multiple taxable bases, multiple rates and difficult rules to define who is competent for collecting the tax when goods or services are supplied.

12 A. GEBAUER, "*Division of German Tax Revenues And The Financial Equalization Scheme Between The Federal Government And The Länder*", EUROsociAL – Workshop Brasilia.