Globalisation and International Harmonisation of Tax Systems

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Introduction

Prof. Ferdinando Targetti: In my view this topic is of enormous interest because it deals with one of the most relevant effects the process of globalisation can have on industrialised countries, namely the effects on the structure of the tax system and on the level of public spending and revenues. Professor Vito Tanzi, whom we have the great pleasure of welcoming here today, will address these issues. It is not the first time he comes to Trento, because he is a member, together with other international economists, lawyers and political scientists of the Scientific Committee of the School of International Studies. Professor Tanzi has been the director of the fiscal affairs department of the International Monetary Fund, under-secretary to the Italian government, and member of the Latin American Development Bank. He has published a monograph, and numerous articles on the topic he will be addressing today, namely the effects of globalisation on tax systems, and is teaching a course for the students of the School of International Studies. Our second speaker is professor Tommaso Di Tano, who is professor of international tax law and a member of the board of the International Fiscal Association (IFA), apart from being a well-known Italian tax expert.

The relevance of the topic arises from the realisation that globalisation causes the factors of production to become much more mobile, thus making it difficult to include incomes from financial capital in the tax base. Moreover, in the wake of globalisation, as professor Tanzi has illustrated in part of his work, sophisticated financial instruments, like hedge funds, are developed, the incomes from which are difficult to include in the tax base. However, the issue concerns not only financial but also real capital. Multinational enterprises may resort to transfer prices, deciding what parts of the overall company to recapitalise according to where it is most convenient to do so. In short, they can engage in a kind of fiscal arbitrage. National enterprises may resort to outsourcing, which means that they will locate a part of their activities where labour costs are lower, not only in terms of wage costs, but also in terms of social security contributions. Something similar applies to trade. Apart from foreign trade, which makes it more difficult to impose some types of taxes, there is also e-commerce, which is a fruit of this process of globalisation of the exchange of goods and production factors. Labour itself is more mobile, and being more mobile taxing the income of non-residents becomes more difficult. Finally, the number of tax havens is growing. Hence we can say that the process of globalisation makes the work of all those who have to impose taxes much more complicated with results on which I would not like to dwell extensively because our speakers will do so in-depth and surely much better than I would be able to do. Nevertheless, globalisation gives rise to phenomena like fiscal competition, fiscal degradation, and tax evasion, with
the result that, as I mentioned, the process of the aggregation of the tax base becomes terribly difficult.

The consequences are economic, political and social. The economic consequences are such that the incomes subjected to taxation more easily become those derived from labour rather than other types of income, hence outcomes in terms of equity that may be politically undesirable. From the political point of view individual countries become less autonomous in the choices they make because of the competition in the area of taxation; a type of competition that aims to increase the ability to finance domestic public expenditures by diverting taxable incomes away from other countries. For all of these reasons, and also from an institutional point of view, an urgent need exists, above all on the part of countries with a developed welfare state, to find ways to limit this erosion of the tax base. This leads to a discussion about reform proposals which go into the direction of harmonisation, or in the direction of designing and creating ad-hoc institutions, like the proposal professor Tanzi has repeatedly put forward with courage and fantasy, in order to pursue this type of global prosperity which otherwise is eroded by this process. I gladly hand over to our speakers. I would say 30-40 minutes each so as to leave some time for discussion. Thank you.
Globalisation and Coordination of Fiscal Policies

(Prof. Vito Tanzi)

Thank you very much professor Targetti. I will have to be brief, also because I discovered that I am losing my voice, which does not happen often to me. Perhaps it is some allergy. We have been in Venice for three days. Perhaps it is the fault of Venice. Hence I will have to try and be brief. Anyway, I am very pleased to be here. I first came to the University of Trento when the planning for the master’s degree in European and International Studies started. I am very pleased to have links with this university. I hope to be able to return more often in the future. It was easier to come to Trento when I was in Rome. From Washington instead it is a bit more complicated. We had to change planes in Paris, right when this disaster happened Sunday morning, and we were at the terminal next door when it happened. Hence it is somewhat complicated and risky to travel.

Anyway, I am pleased to talk about the topic of globalisation and the tax system. I will try to discuss two or thee main topics without going too much into details, starting with the discussion about globalisation.

If one lives in Washington, or in any other place of the world for that matter, at present there is widespread discussion on the effects of globalisation on the welfare state and on the citizens. Fashionable economists like Harvard Professor Dani Rodrik, argue that globalisation is having very negative effects. Professor Baghwati, of Columbia University, in contrast, has frequently taken the opposite point of view. He has recently published a book with Oxford University Press in which he argues that all these criticisms of globalisation essentially are without merit, and maintains that, on the contrary, globalisation benefits the economy. I would like to spend a couple of minutes on the arguments concerning the benefits of globalisation and then turn to the negative effects.

Globalisation obviously leads to a more efficient use of capital. In theory the capital produced, which is to say the savings of individuals and groups, can be invested in those areas and countries where they yield more. This is an American argument. Since the times of president Reagan the United States have continuously claimed to provide the most efficient use of saving. If the rest of the world, therefore, transfers 3-4-5 % of GDP to the US each year in order to be invested, well, this is a positive factor for the world because these savings are being employed in the best possible way. At the time when there was this flight of capital from Latin America, I myself have argued repeatedly that perhaps this was not an altogether bad phenomenon, because these funds would have been squandered in line with the Latin American economic policies of that period. Hence they were taken out of Latin America, and while they were abroad they yielded fairly high interest rates, they did not pay taxes and accumulated very large fortunes, which, in theory, could return to Latin America. Perhaps the same argument is made with respect to Russia. But of course this is an argument
that can be pushed a bit too far. Obviously when capital leaves a country or a region this creates more difficulties for this geographical area to develop. In any case, one needs to accept the idea that globalisation leads to a more efficient worldwide use of family savings.

Naturally globalisation also implies more choices for consumers. Some people object to this argument, but to me the idea that in December or for Christmas I can eat cherries in Washington is something very positive. The fact is that nowadays the majority of consumers has a vast menu of choice. Obviously the poorest always suffer from the problem of being very poor, of not having many choices, but for the large majority of the citizens - 90% of the population – to have a wider array of choices should almost always be a positive fact.

There are more possibilities to get to know the world. In a globalised world travelling has become more affordable, which means that many persons who once upon a time never ventured far away from the village they lived in, nowadays can easily pack their bags and go to New York or Miami, or some other part of the world. And not only the rich, but probably 50% of the citizens of any European country can afford this luxury. Nowadays much more information is available, information which helps many persons and many families. On some occasions and in some of my articles, I have argued that China or South Korea would not have developed as rapidly as they did, if they had not had access to information from other countries which nowadays is readily available.

Hence there obviously are many benefits resulting from globalisation, but there are also many costs. If there weren’t any costs Seattle or Prague or Geneva would not have happened. Obviously there are negative effects of globalisation that we need to recognise and accept. Borders are much more permeable than they once were, and naturally the illegal trade in goods like drugs and arms is easier. This obviously is a negative factor that can and is creating problems nowadays with terrorism etc. Another negative effect is that the transportation of hazardous products has become much easier. Poisonous substances that are produced in an industrialised country sometimes are taken to other countries: Poisonous substances, which are produced in Northern Italy, are taken to the south of Italy and thus there are problems of this type. I remember that Larry Summers, a famous economist who was the US Treasury Secretary, once wrote in a memorandum that it would be efficient to take American waste to Africa. This resulted in an enormous rebellion against him. Obviously the transportation of hazardous materials does pose a problem.

The possibility of epidemics, obviously has increased with globalisation: The fact that the other day a person in Russia died of Ebola because he was conducting experiments with that virus creates disturbing possibilities: If one remembers, for example, the flue epidemic of 1918, which apparently claimed more victims than all of the first world war. If this epidemic were to repeat itself today, with our present level of mobility
of people and goods it would wreak total havoc in a very short time. There are experts in this field who are very worried indeed that something of this sort might happen. The response to SARS, this virus that appeared last year in China and Hong Kong, obviously also gives reasons to worry.

Rapid economic growth may have worrisome environmental effects. The idea of one billion Chinese all starting to drive American cars, or worse still, the cars which were in use in eastern Europe 10-15 years ago, to me always has been a nightmare. Or imagine everyone buying fridges in a short period of time. Naturally I am very pleased that China is developing very rapidly. I used to go to China each year and have witnessed the enormous increase in standards of living, but without environmental agreements on the international level, this may create enormous worries. Just imagine one billion persons acquiring at a certain moment the possibility to drive polluting cars. And we are not talking about a period of 100 years. If the present growth rate in China continues, within 20 years a large part of the Chinese population will be able to afford cars. Thus it is obvious that there are problems. Globalisation turns national problems into international problems in the sense that once a problem remained contained within the boundaries of a country, but nowadays with globalisation it is ever more likely that the problem will transcend the national borders. This brings me closer to my main topic.

Until not long ago, going back in time 30 years, taxation was essentially a domestic activity. Economies were closed, there were few possibilities for the international exchange of goods, international capital flows were modest, and if a country implemented a tax reform, changed a tax rate or a law, the problem was primarily a domestic one. It would have positive or negative effects on that country and nobody abroad would have to worry. In other words, the tax base of each country always was the domestic economy. What has happened during the last 20 years is that with the liberalisation of trade, and the enormous movements of capital at an incredible pace (each day the equivalent of the Italian GDP changes country, this is the dimension more or less), domestic fiscal problems start to become international problems, and this has consequences. One of the most important consequences is that the tax base of a country nowadays no longer consists of the national economy of that country, but, in a certain sense, of the global economy. The global economy has become a sort of commons, like the oceans or the atmosphere, which a shrewd country may exploit for its own purposes. For example, by radically lowering tax rates on incomes from financial activities one can attract capital from other countries. Countries may obtain some revenues by taxing these foreign incomes at low rates. By imposing low rates for excise duties on luxury products one can attract consumers from other countries. With low taxes on individuals one may attract e.g. tennis players, like Björn Borg who left Sweden for this reason. Also Volvo has threatened more than once to leave Sweden. Hence a country may try to exploit this kind of activity may try to
impose its fiscal weight not on the domestic economy, but on the global economy.

Once one starts to recognize this phenomenon, one realises that it is a major problem that at present no institution on a global level exists which deals with these matters. Once one introduces the idea of fiscal competition, i.e. the phenomenon of countries pursuing a beggar-thy-neighbour policy by means of changes to the tax system, one is immediately led to recognise the problem and to start thinking of a solution.

What solutions are there? The first solution is the market. As is the case for many problems one might decide to do nothing and rely on the market. The government stays out of it and the market will take care of the problem. Much controversy surrounds this argument. There are scholars of public finance who argue that tax competition always is a positive factor, because it constrains countries to lower very high tax rates. As we know from the theory of public finance, high tax rates give rise to distortions, so-called welfare costs that are the square of the tax rate. Hence the higher the tax rates the higher the welfare costs. Thus, if tax competition reduces these tax rates, the economy by definition improves, and should function better. By the way, the tax bases that are affected most by this competition are the mobile ones, those of financial capital and of persons with particular physical, intellectual or artistic abilities etc. and the tax rates that are lowered are mainly those of these mobile factors, and those in turn are the factors that cause economic distortions when tax rates are high. Thus there is a positive aspect in all of this.

Some adherents of the public choice school argue that governments per definition do not know how to spend money well and squander large amounts. Governments are spendthrifts, and the more revenues they collect the more inefficiencies there will be in the public sector. If we, therefore, reduce taxes by means of competition we reduce the inefficiency of government and thus the public sector overall will contribute to the improved functioning of the economy.

Those are the two main arguments. But, on the other hand, there are two or three counter-arguments one might mention. The first argument is that, above all, many of the public spending programmes, especially in the democratic environment that exists for instance in Europe, are very difficult to cut. Once taxes are reduced it is not obvious that public expenditures will be reduced as well. What may happen, therefore, is that tax revenues diminish, whereas public expenditures remain at the same level, thus giving rise to public deficits and macroeconomic problems. Hence this is an aspect that needs to be recognised.

The other aspect is that, even if it is true that there are inefficiencies in the public sector, it does not hold automatically true that if taxes are reduced the expenditures that will be reduced will be the most inefficient ones. Very powerful lobbies frequently support the most inefficient spending programmes, and thus it is likely that the programmes that will be
cut will be the efficient ones. During lunch we talked about public works, large projects that are no longer undertaken because frequently the lobbies supporting them are weaker than the lobbies of pensioners, schoolteachers, etc. Hence it is likely that if there are going to be spending cuts it will not be the most inefficient spending programmes that will be cut.

A third point is that a government may react to a reduction of tax rates by introducing more distortionary taxes than those that were eliminated; and I see examples of this throughout the world every day in the form of a tax, which is the most horrendous tax that I know of, i.e. the tax on bank cheques. This tax was introduced in Argentina during the 1990s and slowly spread to Brazil. From Brazil it spread to Peru, from Peru it went to Colombia, from Colombia to Costa Rica, and from Costa Rica it moved to Asia. At present there are a couple of Asian countries who have introduced it, and this tax is further spreading, throughout the world. Each time one writes a cheque and sends it to the bank to be cleared, the bank charges 1% and transfers the revenues to the government. From an administrative point of view this is a very easy tax and that is why governments like it. From an economic point of view it is horrendous, because it creates an incentive for the use of cash and resorting to the underground economy and sooner or later will create problems. Hence these are problems and therefore the idea of tax competition probably should not be accepted without reservations.

Apart from competition, there is much discussion about the harmonisation of tax systems. Also here there are positive and negative aspects. The positive aspect, as I have argued repeatedly when taking part in conferences and also at the level of the European Union, is that the tax bases, especially those of corporations, should be a technical and not a political decision. There is no reasons why the decision what should be the tax base on which to impose corporate taxes should not be left to technicians. The tax rate, instead, is a purely political matter: Hence why not harmonise the tax base and then leave countries free to compete as they please on the rates? Thus there are aspects of the system where harmonisation can have positive effects. At the same time one needs to be very careful with harmonisation, because harmonisation can take place around the most burdensome tax system of the group of countries or can take place around a tax system that is so inefficient that the inefficiencies of one country are passed on to all the other countries. Therefore fiscal harmonisation has to be considered carefully.

One may resort to international agreements, but international agreements are very costly. To negotiate tax treaties between various countries, for example, requires a lot of time. International treaties are very complicated, and are not really an efficient solution. Another alternative, which does not directly provide a solution to the problem but helps us to move towards one, is to create an international organisation that can systematically address fiscal matters. I have written two articles on this
topic: one in 1987-1988 in a book that was edited by a famous American economist of the time, by the name of Herbert Stein, who died a few years ago. The book also contained articles by other people and was entitled "Tax Reform in the Twenty-First Century". In this article I mentioned for the first time the possibility of creating a system of fiscal administration at the international level that could collect information on many countries and that perhaps, perhaps, one day might impose taxes. Then I rethought this idea in 1995 in an article that also has been published in a book, and which more explicitly presented the idea of a tax organisation.

What would this organisation do? First of all I should perhaps mention that strangely enough, at present there are very many international organisations. In fact, these organisations constitute a kind of proxy for a global government. No global government does exist, but mainly since the Second World War, dozens and dozens of international organisations have been created that have the responsibility to deal with a certain element or problem. The World Bank deals with the problem international development; the International Monetary Fund is concerned with the macroeconomic aspects of international development, the World Trade Organisation deals with international commercial exchanges, the WHO deals with health etc.

But strangely enough in the field of taxation, which is a matter of the utmost importance, no organisation exists. As I said earlier, taxation nowadays has cross-border effects. If Italy imposes a tax of 12.5% on financial incomes, which is much lower than in other countries, obviously the financial incomes will start to migrate towards Italy. If instead Antigua or Barbados introduce very low tax rates, the incomes will move in that direction. Hence, as I already mentioned, there obviously are international repercussions; and therefore the idea that there should be an organisation that would be able to deal with some aspects of tax systems to me seems to be a valid one.

In fact I would like to pass on some interesting information to you. Kofi Annan had fallen in love with this idea, not for my reasons but for reasons of his own. The United Nations were preoccupied with how to obtain the revenues to finance their activities. If the Americans don’t like what the United Nations are doing they do not transfer their contributions to the UN as was the case for a long time. For this reason the United Nations liked the idea of a Tobin tax or of other taxes of this kind. There was the idea to impose a tax on airplane tickets, the revenues of which might be transferred to an international organisation that in turn would fund the United Nations. Kofi Annan introduced this proposal in the report he was supposed to present at Monterey in Mexico two years ago when there was this big international meeting on economic development. But once the OECD got wind of what was going on it started to lobby the G7 and succeeded in having this proposal removed. Hence the report Kofi Annan presented at Monterey no longer contained this proposal.
What would a world tax organisation do? It would do several things. First of all would be the identification of the major trends in the field of taxation and of the problems that emerge at the international level. At present there is no organisation at the international level that has an overview of what is happening in the world and publishes a report. Strangely enough an annual or bi-annual report on international fiscal systems does not exist. During the last couple of years, while working at the IMF, I have tried to create such a report, but without success. If one wants to know what is happening in the world, also from a statistical point of view, if one wants to do comparative research on the fiscal burden and the tax rates of various countries it becomes extremely complicated to do so once one goes beyond the 28 countries of the OECD. For the 28 countries of the OECD the information exists more or less; but once you want to introduce China, Brazil or Mexico, it becomes extremely difficult, because the information that exists is dispersed. Hence the first thing would be to provide this information.

The second task would be the compilation of appropriate statistics and information on taxation for the largest possible number of countries. Thus, first identify the trends and then produce the statistics. Maybe publish a world tax development report, an annual report that could indicate the trends. What is happening in the field of taxation? Is the income tax being replaced by a dual income tax? Are we moving towards a single-rate VAT, as many experts claim, or a VAT with differential rates as many politicians would like? Are tax bases being harmonised or not? All this information presently does not exist and it is very difficult to know what is going on. Such an organisation could lend technical assistance to various countries, especially with respect to aspects that are of importance also to other countries like tax competition and fiscal degradation. It could develop basic norms for tax policies and the tax authorities. For example some American experts have tried to put together a world tax code, a set of general principles. An international tax organisation could establish a set of principles like exactly how to deal with the tax payers, or concerning some administrative aspects like the use of computers. All this information is present in the minds of some experts but is never put together.

More important than all this is to provide a global forum in which politicians and experts can exchange ideas on fiscal matters. At the IMF, for example, when each year macroeconomic policies are discussed and recommendations made, all the countries of the world are represented by their policy directors. Each year one discusses Italy, the United States, Great Britain, etc. But there is no forum where the tax policies of the individual countries are discussed. Hence it would be a venue where countries that are worried about, let’s say fiscal competition or fiscal degradation, can express their views.

Another task might be to provide a global forum for fiscal arbitration in case of frictions or conflicts between countries or groups of countries.
To a limited extent the World Trade Organisation (WTO) at present deals with such matters. When there was a problem between the United States and some European countries, concerning some American export incentives the WTO dealt with this aspect. But the WTO does not have the leverage and experience, nor the international technical expertise that a world tax organisation would have. Finally an international tax organisation could survey fiscal developments in the same way in which the International Monetary Fund watches over macroeconomic developments.

Hence those would be the main activities. Perhaps one day one would arrive at a point where the Americans, the British, the Italians, etc. would be willing to cede a bit of their political power to an international organisation in order to impose some taxes. Like for example environmental taxes on energy consumption in order to finance public goods at the international level, Such an organisation might be helpful also in this respect.

I stop here because I do not want to use up more time. Thank you very much.
International Perspectives of the Italian Tax System

(Prof Tommaso Di Tano)

I must say that I am always very struck by the presentations of economists and experts on public finance, if only because of your capacity to capture reality, the capacity to depict a horizon, to single out the historical directions in which the world must move, is a capacity which fascinates me. And it fascinates me, if only because I have another profession. I occupy myself with how those intentions may subsequently be translated into prescriptions; i.e. how to move from a direction one would want to follow to a formal norm, a coercive instrument which causes this direction to be taken in fact. And then how to interpret this sequence of words, because the rule may have a certain intention, may capture in its wording its objectives in the best way, but in the end a rule / regulation is nothing but a set of words, a sequence of words, subject, verb, adjectives, commas, periods, and so forth. Hence there is a technical problem of translating a thought into an ensemble of prescriptions. Moreover there is the problem of the passage of these prescriptions from the hands of those who drafted them into the hands of those who have to implement and interpret them. Those who interpret them not always are of good will, they do not all have the same capacities, and the same intellectual integrity that may have inspired the author.

When we are going to venture into the topic of the international outlook of the Italian tax system, we have to consider where we came from, what we have achieved and what results we might reasonably still achieve.

Let’s start with where we came from, i.e. what is the Italian tax system? The Italian tax system is of medieval origin, and thus a system created around a territory and centred on a territory. The typical medieval taxes were the customs duty and the tax on landed property. The Italian tax systems comes from there and from there it has tried to evolve. The principle on which this system was based, is a principle which, taken overall, was sensible, namely the principle that the control of a territory corresponds to the control of the wealth exchanged on that same territory.

This principle is the one which inspired the tax reform of 1971. Today, in 2004 we find ourselves in a new context as far as taxation is concerned, but the truth is that the Italian tax system is still the one conceived by law no. 825 of 1971. And this law is still based on the conception that the control of the territory equals the control of the wealth exchanged on this same territory. Professor Tanzi has told us that this clearly no longer is the case. But if this no longer holds true one needs to verify to what extent the Italian legislation has already taken this into account and to what degree it would need to evolve further.

It seems to me that the Italian legislation has essentially exhibited a defensive approach until the beginning of the 1990s. Between 1992-1993 I
would locate a sort of turning point. It is not by chance that 1992 was the year in which the Lire exited from the European Monetary System, and the year in which the big privatisations were launched. During 1992-93 a host of state owned enterprises were transformed in joint stock companies, like the Institute for Industrial Reconstruction (IRI), the state energy company (ENI), the postal service, the state railways, the National Insurance Institute (INA), the Institute for Industrial Real Estate (IMI), and so forth. In this same period Italy signed the Maastricht Treaty and committed itself to the so-called EMU convergence criteria which were to lead to the birth of the Euro. In 1993 the most rigorous budget of the last 30 years was presented, namely the budget of the Amato government. Hence 1992-1993 is a conspicuous period for the economic policies of our country and fortunately also as far as the structures and norms that govern taxation are concerned.

From a legal point of view, I might mention the introduction of the directives concerning company transactions. Here we are talking about transactions that may involve mergers, cessation of enterprises, restructuring of global participations, etc. These are all transactions in which a fiscal variable is present. A variable not made up of tax rates, but which consists of uncertainties, not knowing what regime applies. If one does not know what the applicable tax regime is, certain transactions simply will not be undertaken. Hence, for an international transaction, which usually is a complex transaction, the first thing required is certainty about which tax regime applies. But in Italy until 1997 tax ruling basically did not exist.

Moreover there is the issue of exchange rates. Nowadays with the advent of the Euro there is a pronounced reduction in the incidence of this item, but until 1999 15 different currencies existed within the European Union. To trade with the EU hence meant not only to set a price, but to set a price discounted for the fluctuations of the exchange rate. Alternatively one might hedge against exchange rate risks insuring that particular transaction by means of currency swaps; possible but costly. Hence the regime of flexible exchange rates was a regime that particularly penalised Italian companies from a fiscal point of view, with the result of constituting, if possible, an additional obstacle to international trade. Between 1988 and 1992 the disadvantages arising from a regime of flexible exchange rates, however were progressively reduced.

Moreover there are strong restrictions on the use of the so-called foreign tax credit. What is a foreign tax credit? Foreign tax credits are the taxes paid in another country. Hence an Italian taxpayer, who runs an activity in a country other than Italy, probably pays taxes in the other country. All the tax system of the world dispose of a mechanism to recuperate taxes paid in another country and it existed also in Italy, albeit that this mechanism functioned in a particularly precarious way at least until 1988. Since then it has progressively improved, and at present, I must
say, it is an entirely adequate mechanism, but until 1988 this mechanism functioned very badly.

In addition, there is the issue of the indeterminacy concerning the definition of a branch. What does this mean? Concerning all the activities undertaken in a foreign country by an Italian company the problem arose of how they should be considered and how they should be taxed. If these foreign activities could be subsumed under the concept of a branch, which in the field of tax law is called a stable organisation, they would have had a certain type of regime and potentially some benefits. If instead they would not fall under the concept of a stable organisation there would be complete uncertainty with respect to the regime and most likely no benefits.

In addition no definite regime was in place concerning both the transfers of the headquarters of companies as well as the change of residence for individuals. There was no special status for international managers. One might remark that this is a trifle but instead it is not. To operate in an international context means that not only goods but also brains move. Hence a country that wants to promote a certain type of technology cannot but go and look for the brains capable of developing these technologies wherever these brains are produced. But such brains are predominantly produced in a certain type of university, unfortunately rarely Italian ones. Since this is the reality, whether or nor to provide particular rules concerning the mobility of top managers means to enrich or impoverish the growth potential of a certain country.

As an example of a kind of indifference towards the fiscal mechanisms typical of international relations I mention the so-called cost sharing agreements and the coordination centres. What are cost sharing agreements? Cost sharing agreements are the typical subdivision of costs incurred within a group, like e.g. the IBM group, or the FIAT group, or the Pirelli group or the Prada group, the Gucci group. It may be that the group undertakes certain activities that benefit its own controlled companies in Italy, Britain, Germany, France, the US, Canada etc. But it is obvious that it would not make sense to spread these activities, which benefit the controlled companies belonging to different legislations and hence to various tax systems, throughout all these countries. It makes more sense to concentrate them in a single country. And in which country will they tend to be concentrated? It will be the country where this particular resource is best available. Hence if we talk about, let’s say chemical industry, probably the most appropriate country will be Germany. If we talk about the iron and steel industry, that country might be Japan. If we talk about fashion and design that country will probably be Italy. Once these activities, which produce benefits for the controlled companies spread throughout the world, have been concentrated in a single country, it should be possible to distribute their costs over the various controlled companies. Well, in Italy unfortunately legislation concerning cost sharing agreements did not and does not exist.
Nor did a regime concerning so-called CFC's (Controlled Foreign Companies) exist. What are these CFC’s? The CFC legislation is a regime that tends to suppress the use of tax havens. I mention the absence of CFC legislation as a sign of the scant internationalisation of the system and I mention it on purpose because it is rather evident that where no instrument exists to repress the use of tax havens, those tax havens will be used, and will be used in the worst possible way, i.e. in order to transfer the maximum amount of profits to the tax haven, where in reality no economic activity whatsoever takes place, and the maximum amount of costs to where the real activity is located. Thus, concentration of costs in Italy, and concentration of profits in the Dutch Antilles. It is beyond doubt that a country that wants to play a role in the international context must dispose of legislation against tax havens.

This is where we came from. Now let’s see where we have arrived, and this I would like to examine from different perspectives. The first perspective is: where have we arrived thanks to the European Union, in other words, what share of the Italian legislation in matters international is the fruit of decisions coming from Brussels and not of our autonomous choices. The second perspective is: what is the autonomous impetus originating from the Italian parliament, distinguishing measures promoting foreign investment in Italy from measures to promote Italian investments abroad. Finally I will examine the remaining obstacles, notwithstanding innovations, which no doubt have been introduced in this framework.

I start with the first point, i.e. what is the impetus towards an improved internationalisation of the Italian economy and the Italian tax system originating from the European Union. Without doubt the major impetus came from two directives, parent-subsidiary, and the merger directive, adopted in Italy between 1992 and 1993. There is a third directive on the same subject matter, which deals with interests payments and royalties between parent and subsidiary, i.e. between controlling and controlled companies. This has been a very interesting impetus because it effectively tends to constitute the territory of the EU as a single territory for the purpose of taxation, at least as far as flows are concerned. We do not yet have a single territory as far as tax rates and bases are concerned, but at least the territory tends to become a single one as far as the flows of dividends, interests, royalties and company transactions is concerned. Thus this impetus originating from the EU is very interesting.

Whenever one talks of the system of taxation it seems as if in reality we have two disjointed systems that do not communicate with each other. On the one hand there is a system of taxation connected to individuals, which typically is a more locally oriented one. On the other hand there is a system of taxation concerning the business world, which by the nature of things is internationally oriented. The impetus originating from the European Union in matters of company law and in matters of legislation concerning the annual balance sheet, also has been rather significant; in
particular the second and third directive and the recent directive concerning
the creation of the so-called European Company (*Societas Europea*). As far as
the ordinary and consolidated accounts are concerned, the fourth and the
seventh directive should be mentioned, and more recently, i.e. in 2002, the
adoption of the IAS (International Accounting Standards) as the
international accounting principles used in the countries of Europe. So this
is the impetus coming from the European Union.

Alongside the impetus originating from the European Community
there are the autonomous interventions of the Italian legislative. One has to
bear in mind that in this area there exists a possible contradiction exists
with the hypothetical creation of an supra-national organisation for matters
of taxation. The contradiction lies in the fact that the Italian constitution
establishes that the rules in matters of taxation have to be promulgated by
means of laws. Hence taxation is not a matter that can be handed over to
the government. It is a matter that in any case has to be voted on by the
respective parliaments. Handing over the Italian tax system or part of it to
an international organisation is not impossible. But it would be possible
only on the condition that powers were delegated to this international
organisation not by means of an ordinary law, but by a law of constitutional
rank, which obviously implies different majorities: Normal laws require an
absolute majority of deputies present, - assuming that the session of the
chambers of parliament has been correctly convened - whereas the majority
required in order to modify a law of constitutional rank is always a majority
of 2/3 of the Italian parliament. Hence it is quite well possible that more
than one government has considered participating in an organisation of this
kind, but may have straddled faced with the political difficulties of
advancing a project of this kind.

I add that I would have doubts and reservations on the constitutionality
of a delegation of authority without temporal limits. It would be quite well
possible to confer upon an international organisation the authority to
legislate in matters of taxation by means of a law of constitutional rank, but
I doubt that this can be done by means of the instrument of the delegating
act, given that such acts according to the Italian constitution must contain
well-defined temporal limits. Hence I perfectly understand the significance
and importance of the message, but I am afraid that the Italian legal
framework is characterised by excessive rigidity, which does not permit
joining this international organisation.

I now come to what has been done so far, distinguishing measure to
promote incoming and outgoing investments.. So, what has been done to
promote incoming foreign investment? Honestly, the first thing that comes
to mind is the legislation concerning the dual income tax. The dual income
tax, as you all know, has been abolished as of January 1, 2004. Personally I
hold this abolishment to be an error, a serious error. Nevertheless, the
legislation concerning the dual income tax certainly was a legislation that
tended to promote incoming foreign investment. Hence the abolishment of
the dual income tax to me seems to be an particularly serious error, but this is typical of the interventions of the Italian legislative to promote incoming foreign investment.

Regarding the promotion of incoming investment I would also like to mention that finally legislation in matters of CFC has been introduced, for the reasons I mentioned earlier. Moreover I mention the introduction of a host of instruments that essentially can be grouped under the heading of tax ruling.

Why do I choose my words so carefully when talking about tax ruling? I choose my words carefully when talking about tax ruling, because, tax ruling according to a quite widespread interpretation, i.e. according to a non-technical approach, is a kind of a meeting point between the tax authorities and the taxpayer. Now it is true that tax ruling does mean this, but it is also true that the ways to arrive at such an agreement are quite diverse.

First there is what we may call tax ruling, in its Latin or Mediterranean version. Tax ruling in its Mediterranean version is nothing more than an agreement on the interpretation of a rule regarding a particularly complex matter; a matter particularly difficult to understand, which perhaps has been interpreted differently and on which the taxpayer might be interested to obtain clarity. Thus there is a first type of tax ruling that simply serves to say: “The colour of this curtain is green. Some might maintain it is light blue, other that it is grey.” Here one needs to find an agreement. The taxpayer presents his hypothesis of the correct interpretation of the rule, and says according to me the rule has to be interpreted in such a way that the curtain is green; and the tax authorities decide if it is green or if it is not green. This is a type of tax ruling whose purpose simply is to define what the correct interpretation of a rule is, and that is what we may call Mediterranean tax ruling.

Then there is the Anglo-Saxon tax ruling and the Dutch tax ruling. The Dutch tax ruling is a different thing altogether. Here the tax payer goes to the tax authorities and says: “I am Mr So-and-So of the Channel Islands company X and I would like to buy the company Y which operates in Germany, and has stable organisations in Italy, Greece and Spain. I want to buy 100% of the shares. I want to merge the four stable organisations that it controls and want to resell 49%. How much will the Dutch tax authorities charge me?” This, as you can see, is a different thing; here the object is not the correct interpretation of the legislation, here the object is to define the fiscal costs of a certain operation, i.e. how much tax will have to be paid on that particular operation. But be aware that this is a quite different matter, which in Italy we would not call this tax ruling, we would call it definition of the fiscal costs of a certain transaction. Now, this type of tax ruling does not exist in Italy. Perhaps afterwards during the discussion we can debate whether it would be opportune to introduce it. But this type of tax ruling we do not have in Italy.
There is another type of tax ruling. Article 27, paragraph 4 of decree no. 600 is interpreted in terms of tax ruling. Between 1997 and now, a series of instruments have been introduced in Italy that go by the name of tax ruling, and which have the goal of clarifying the rules: they are the tax ruling of article 37 bis.

With decree 269 of 2003 a further form of tax ruling has been introduced which is called, as published in the Gazzetta Ufficiale, international tax ruling. However, this is not tax ruling of the types mentioned before, i.e. it is neither an interpretation of a law, nor the Dutch type of tax ruling nor an agreement. It is a somewhat different thing. It is something which the Americans call advance price agreements. Advance price agreements concern the definition of the value of an international transaction, usually conducted inter-company. This is a very important matter for the following reason. Advance price agreements are concluded in the case of a company located in one country, which does business with a company in another country belonging to the same group.

As an example one might think of Coca Cola. Coca-cola is American, but when we buy a bottle of Coke in Italy we don’t buy a drink produced in Atlanta. Instead we buy a bottle the contents of which have been manufactured in Sicily or in Verona or Asti. Thus we buy a product which is perfectly Italian, except for the fact the this product is made according to the recipe of Coca-Cola, and Coca Cola in Atlanta charges the Italian bottler a royalty for the use of this recipe. Hence for each bottle produced and sold for, let’s say 100 lire, 3,5-4 lire must be paid as royalty. These three and a half lire which are paid to Coca Cola are they a correct or incorrect price? God knows what the answer to that is. How to define if this price is correct or not? Put differently, how to define whether the market value of this royalty is a correct value or an altered value, i.e. a transfer price?

There are many techniques to define transfer prices. On the issue of how to define a transfer price there has been an important court case in Italy, namely the one concerning Chiquita bananas. The Italian importer of Chiquita bananas maintained that a particularly high royalty could be paid, but the Italian tax authorities disagreed. In this case it was particularly simple to define what was the correct price of Chiquita bananas: it was sufficient to verify at what price bananas were quoted on the international market, and to compare this to the price in Italy. Thus it was fairly easy to reach a conclusion.

But how to define the value of a CD produced by Microsoft, which includes not only the software, but in addition customer support and the updating of that same software? How much is such a service worth? How to define the value of this service? The same applies when one participates in a big group like the Vodafone or the Lockheed or Boeing group, and one has to arrive at a definition of the value of the maintenance of an airplane. What is the value of the maintenance of an antenna? God knows. Thus the advance price agreements serve the purpose of reaching an
agreement between the taxpayer and the authorities concerning the value to attribute to a particular transaction. The fact that in Italy advance price agreements have been introduced certainly puts the Italian tax system in line with the other tax systems of the world. These are the measures concerning inward foreign investment; now let's have a look at those concerning outgoing investments.

As far as outward investments are concerned I would say that the best measures are those that relate to the introduction of a complete foreign tax credit, i.e. the possibility to recoup in Italy the taxes paid abroad. In Italy it is now possible for companies to be taxed on the basis of a consolidated global balance sheet. I must say that in this regard we are truly in the forefront because, as far as I know, the Americans do not have a consolidated global balance sheet. Only few countries have it. We in Italy have it, the Danes have it; the Dutch have it. A fairly limited number of countries has it. We do not yet know how it will work because it has been introduced in 2004, and we therefore have not yet seen how taxation on the basis of a consolidated global balance sheet functions, but it is a fact that the legislation exists. As I already mentioned Italy has introduced legislation both concerning CFC’s and advance price agreement and we have also adopted a system of participation exemption concerning taxation of dividends and capital gains, which applies to both resident and non resident companies distributing dividends or realising capital gains. Hence also this to me seems to be a measure of particular interest in order to facilitate outward investments.

What then are the remaining hurdles for national legislation to remove?. The main hurdle I would consider to be the relative inability of the Italian tax authorities to enter into dialogue with foreign tax authorities. All said and done, a tax system is not just a system of rules, but also a system of implementation of those rules. A tax system therefore, apart from being a structure of rules, is an intelligent system if those who manage these rules are prepared and intelligent, but it becomes a stupid system if those who manage it are ill prepared and not very intelligent. The Italian tax administration does not particularly distinguish itself, neither in terms of preparation nor in terms of intelligence, but particularly not with respect to the use of the English language. And here there is no alternative, international relations are conducted in Esperanto and the modern day Esperanto is English. Who wants to operate in an international system thus first of all needs to learn English and then, or simultaneously, how to use the computer. It is beyond doubt than English and the use of computers will have to go hand in hand and that otherwise there will be no internationalisation. Hence this first point, according to me, is of particular importance because this truly depends on the commitment of the tax officials. The officials will have to make an effort in this field if they want to internationalise their fiscal apparatus.
The second point that I see as a constraining factor is the excessive level of withholdings applicable on some flows. The most important flows in a country that properly wants to be advanced are those with respect to interest payments, even more so than dividends, and all flows that derive from immaterial rights like patents, trade marks, know how, software, etc. The fact is that particularly high levels of withholdings are applied in Italy, whenever these types of payments involve a foreign country. Of course there are the tax breaks provided for by treaties against double taxation, but the level of these withholdings is too high on average. And this clearly is a disincentive for the further internationalisation of the Italian economy.

Moreover there is the impossibility to deduct losses resulting from foreign participations outside of the consolidated balance sheet, with the effect to push Italian companies who want to operate in an international context, to increasingly use the instruments of the branch instead of the instrument of the subsidiary, and mind the difference. An Italian company that decided to operate in a foreign country presumably cannot but incur losses during the initial period. If you create a start up in a country it is inevitable that you make losses during the first three to four years. If the Italian parent company creates a controlled company abroad the deduction of these losses is impossible. However, if the same Italian company invests in a foreign country establishing a branch, then the losses become tax deductible. Hence the difference is too pronounced and unjustified.

I add that the reason to engage in foreign activities in the form of a subsidiary lies in the fact that the subsidiary is a company with limited responsibility. If the company is loss making, in the worst case the capital is lost. The branch instead is an integral part of the parent company in Italy and hence the losses of the branch immediately become losses of the controlling Italian company, also from the point of view of civil liability: So on the one hand these loses imply some fiscal benefits, but on the other hand they lead to a terrible disadvantage of an entrepreneurial nature. I stop here.
Discussion

I am Jonathan Hopkin of the London School of Economics. I will take advantage of the fact that no one else wanted to ask a question to point out something that in fact runs counter to the content of these very interesting presentations, which have addressed above all problems, related to the taxation of capital. I would like to underline the fact that the major part of tax revenues in European countries in reality does not derive from there. I think it would be incorrect to conclude that the overall public expenditures, in the European welfare states are at risk as a result of those dynamics. These dynamics no doubt are important, but if we look at countries who have traditionally had an open economy like Sweden, which is also the country with the highest level of taxation, we see that these are countries where taxation of capital has always been of lesser importance than direct taxes and income taxes. Hence I merely wanted to underline this fact in order not to give rise to the opinion that the European model, in which half of GDP is spent by the state, is at risk.

Prof. Vito Tanzi: That is a very interesting observation, but I think that the problems go beyond the taxation of capital. For example, one of the revenue categories that have experienced an enormous decline is the taxation of luxury items, i.e. the excise taxes. If one looks at the OECD statistics one sees an enormous reduction of these taxes over the years. The reason is very simple: As I explained in the lecture I gave this morning, previously people did not travel and hence it was possible for a country to impose high taxes on watches, television sets, jewellery, etc. If nowadays a country imposes high taxes, people will go to New York or Hong Kong, or wherever it may be to buy their photo cameras. That is why these taxes have been reduced.

The same thing has happened with the marginal tax on the incomes of individuals, which in Great Britain, for example once went up to 99%. In the United States, when Reagan became president these tax rates were 70% at the federal level plus 10% at the state level. In fact I stopped to teach in this period because when I went to the International Monetary Fund while continuing to teach I received 20% and the government the remaining '80%, so it wasn’t worth it. All these taxes have been reduced enormously and at present on the international level; the rule for the taxation of individuals is around 30%.

The dual income tax is another phenomenon of this type. In the past progressive taxes were applied to the sum of all incomes, but very high progressive taxes were no longer possible when capital mobility had become very high, and thus they have been reduced. There are therefore effects that go beyond taxation of capital. Certainly capital and company taxation is the most interesting from an intellectual point of view. But there are other taxes: The Swedes go, I don’t know where to buy their liquor.
When Canada tried to impose taxes on tobacco they found out that many Canadians, a large part of whom lives within 50 miles of the United States, crossed the border and bought their cigarettes in the United States. There are many examples of effects that go beyond the taxation of capital.

Salve. Francesco Terreni, I am a journalist with the newspaper "l’Adige". I would like to ask both of you at what point the initiative of the OECD concerning tax havens and the so-called harmful tax competition is? In addition, what do you think of this type of initiatives? If I am not mistaken, those countries identified as tax havens have until 2005 to demonstrate their adherence to a series of measures. Hence I would like to know at what point the matter is and what you think of this type of legislation.

Prof. Tommaso di Tano: Earlier I referred to the introduction of the CFC legislation in Italy. The CFC legislation derives from a recommendation formulated by the OECD, essentially adopted by all the other 14 EU countries. Italy has been the last to introduce anti-tax-haven legislation. The introduction of this legislation is the outcome of a true cooperation. One might say that here we witness the implicit creation of this world tax organisation to which professor Tanzi referred. Such an organisation has not been created but this recommendation of the OECD goes exactly in this direction, i.e. it goes in the direction of avoiding that tax havens diminish the tax bases of countries that are not tax havens. Hence those countries that are not tax havens; let’s call them major league countries, and do not adopt legislation against tax havens in the end do not create competition for the tax havens but for other major league countries. If Italy does not introduce legislation concerning tax havens, it does not compete with Bermuda, but with France, Germany, Spain etc. The fact that Italy now has introduced this anti tax-haven legislation is simply a sign, one may say, of international solidarity, of observance of an international duty.

Having said this, it is a different matter to say that the way in which the anti tax haven legislation is implemented is correct. I know this is a contentious point of view, but it is my opinion that not all tax havens can be considered the same. When we think of tax havens we usually think of countries with a particularly low level of taxation. But the truth is that we think there is a particularly low level of taxation because controls are lax. Let me explain. The tax rate in Malta is 35%. Hence if one had to say whether Malta is a tax haven the answers would be, no Malta is not a tax haven because the level of taxation 35%. Unless of course one enters into the details of Maltese tax legislation. Here one may arrive at an agreement with the Maltese tax administration concerning taxation, at a rate of 35% by all means, but with a tax base reduced to 5%. Hence we are talking 35% of 5%, which is 1.7%. To identify a tax haven simply on the basis of the applicable tax rate can be strongly misleading; it is necessary to verify the
tax burden in absolute values. Once you embark on this course one may
discover that also some Major League countries are tax havens. For
example, one may easily discover that not Switzerland but the Netherlands
are a tax haven. One may discover that in certain respects Canada is a fiscal
paradise. Ireland, according to the Italian legislation concerning tax havens,
is a tax haven. And mind you, the Italian legislation is less rigid than the
rules suggested by the OECD.

According to the OECD a country is considered a fiscal paradise if the
applicable tax rate is less than 2/3 of the nominal tax rate of the own
country. Hence, if we were to apply this rule for Italy where the nominal
tax rate is 33%, we would have to conclude that all countries in which the
tax rate is inferior to 2/3s of 33, i.e. 22%, are tax havens. Ireland has a tax
rate of 12.5%, and according to this criterion we must therefore conclude
that Ireland is a tax haven. But be aware that this is only so because having
pursued a virtuous budgetary policy Ireland finds itself with a very modest
public debt and a basically non-existent budget deficit and therefore has no
need to augment its tax earnings. Hence, on the one hand there are
principles and, in principle I strongly agree with the approach of the
OECD. But when we proceed to the implementation, as always, the devil is
in the detail.

Prof. Vito Tanzi: I would like to add some comments, more or less of a
political nature. Until 9/11 the United States were not very interested in
this discussion. Paul O’Neil, for example, who was the American treasury
secretary, showed very little interest in this argument. After 9/11 especially
the Americans have changed position and this has given an impetus to this
activity. But as professor Di Tano said, there are problems. Estonia, for
example, which has now become a member of the European Union, does
not have corporate taxation. It only has a tax on distributed dividends. If a
country does not pay dividends, taxes are zero. Hence it will be interesting
to see what will happen. One of the problems, for example, of Caribbean
countries is that many of them have very low public expenditures, and
therefore do not need income taxes for example. If a country only spends
10-20% of GDP because it does not have armed forces, and little
expenditure, what right do other countries have to say ‘you should have a
tax system like ours’?

Let us return to the argument I made before about harmonisation. What
does one harmonise? Do we harmonise from the top to the bottom
or from the bottom to the top? Initially the OECD had created serious
diplomatic problems when the head of the fiscal unit of the OECD, who is
a medium level bureaucrat, wrote a letter to the prime ministers of various
countries saying ‘you need to do this and that otherwise we will do such
and such’. I remember talking to some of these ministers when I was still at
the IMF and they told me: one fine day we receive a letter from an
organisation we are not a member of and from someone we have never
heard of and whose position we do not know, threatening us with all this. There has been a strongly negative reaction. But obviously now the fight against terrorism has entered this picture. The United States now have also pressured the IMF to deal with these matters. Moreover, the Financial Action Task Force on Money Laundering (FATF) has recently been given much more funding and powers. Thus something is happening. The problem remains that many of those countries do not impose some types of taxes of which they have no need.

Prof. Tommaso di Tano: I said before that tax havens are not all the same: In fact it seems to me, also in the light of 9/11 that the question is badly put. When we talk about tax havens we think above all about the tax rates and the lack of controls. Therefore, we need to distinguish: one thing is a tax rate in the presence of a system of controls. In the Swiss system controls exist. Next one may discuss if and when the bank secrecy act may legitimately be upheld. But in Switzerland controls exist. In Ireland controls exist. In Estonia there is no tax, but there are controls. But another thing altogether are un those countries in which, together with the absence of taxation there is also opacity in the movement of funds and the accounts., and here we all agree. It is another matter to say let’s put pressure on countries with low tax rates, for the reasons professor Tanzi mentioned. Who sets the tax rate? Who says that that is the minimum level around which one should proceed with harmonisation?

Prof. Ferdinando Targetti: I do not believe that countries with low tax rates should be required to raise them. Nevertheless there is room for agreements; exchange of information; harmonisation; to distinguish between capital incomes from residents or non-residents. A country may continue to have the tax rates it chooses, but if it fails to distinguish between these two types of incomes it will surely create an effect on the economy and society of the countries from which the capital originates.

Prof. Vito Tanzi: This is true, but in one of my articles, I think it was called "Can information exchange be effective in taxing cross-border income flows", I raise many doubts on how much headway one can make with the exchange of information for various reasons which are explained in that article, for example transaction costs. Frequently countries do not have the information they are asked to provide and must collect it. Collecting information costs money. Then there are language barriers, just imagine Russia and Japan, or Finland having to exchange information. Thus there obviously are large difficulties. Moreover, there are questions of definition. What is interest income? In the US, for example, interest income is adjusted for inflation, in other countries it is not. Moreover there is the issue of the exchange of trade secrets. Just imagine the US asking France for information about Airbus and France asking the US for Information
about Boeing. Hence there are all of those problems which one needs to recognise. I have been director at the IMF for twenty years and the seven years before that I was head of the division of the IMF which deals with taxes. In those 27 years I have had many opportunities to talk with the directors of national tax authorities and whenever I asked how much exchange of information they had with other countries the response almost invariably was ‘none’. Hence there is much talk and very little action. Unless we start to take this problem serious, we will keep having the problems you mentioned before.

Prof. Ferdinando Targetti: The Swiss banks with their bank secrecy act, have committed themselves, when they receive funds from US citizens, to ask if these funds are of American origin because they have been asked by the American tax authorities to provide this information.

Prof. Vito Tanzi: How do they know whether the person depositing the funds is the owner?

Prof. Ferdinando Targetti: They ask. If bankers resolve to find out something, in my view, they have a certain ability of actually doing so.

Prof. Tomasso di Tanno: No, it is not that I do not agree, I say that those who take their money to Switzerland without wanting to be identified do not go under their own name but under the disguise of a Panamanian company.

Question from the floor: Because I think that in reality the exchange of information is essential for the tax authorities. I also believe that concerning this international tax ruling that has been envisaged, a more profound knowledge of the fiscal treatment that certain transactions may undergo in certain countries will be essential for the correct application of these rules. In order to promote this exchange of information international organisations, the OECD in this case, might perhaps make a greater effort by providing definitions - without imposing them - states could use and refer to. Here the issue is to provide perhaps somewhat more precise definitions of the tax base, or of royalties rather than definitions of a general character. This could create incentives for the exchange of information, by creating a common lexicon in which a certain term corresponds to the same value and the same meaning for everyone. Thank you.

Prof. Tomasso di Tanno: My information on the exchange of information is somewhat less pessimistic. At least recently, it seems to me, the exchange of information functions slightly better and most certainly functions better than during the discussion of a directive concerning advanced price
agreements, which does not yet exist. But the fact that the matter was discussed at the EU induces the tax authorities of the various countries to try and truly coordinate their actions. To my knowledge a task force has been set up in Brussels, in which tax investigators of the various European countries participate. Hence, this has been put into practice already and is not a mere hypothesis, and there is no doubt that to have common interpretations at least of the major categories relating to international transactions, would be a good thing, e.g. to provide a common interpretation of, let’s say, stable organisations, interest, dividends, and royalty. What are these flows from a fiscal perspective? In addition one could also provide a common way of presenting bank accounts. I do not see why one could not issue a directive concerning the presentation of checking accounts, as has been done for balance sheets in which it was established that the heading A refers to, let’s say revenues, heading B refers to, for example, extraordinary operations, heading C operating costs etc. I do not see why what has been done concerning balance sheets, first of banks and subsequently also of other companies, could not be done also in the area of taxation. This would be much less far-reaching than the harmonisation of the tax base; it would merely mean the creation of a common language.

Moreover, I would like to re-emphasize a point I made before, namely that the officials of the Italian tax service do not know English. To me this is the decisive element. Once one exchanged telexes, nowadays it is done by email, but the official of national tax administrations, need to be able to communicate. Officials investigating e.g. the normal value of the transaction of Microsoft or General Motors or British Petroleum, or whoever it may be, face the same questions throughout Europe. It is a problem of European dimension, hence it is difficult to understand how one could conceive of an assessment of the normal value of British Petroleum in Italy and not do so simultaneously in the Netherlands. But the reason why this coordination does not take place in practice is that the officials who are conducting a certain type of investigation do not talk to each other, or at least the Dutch would like to talk to the Italians but the Italians are not able to talk to the Dutch.

Prof. Vito Tanzi: I believe that our different viewpoints mainly derive from the fact that professor di Tanno is talking about the European Union or also the OECD. The OECD consists of roughly 28 countries with 7-8% of the global population, the European Union a bit less, But one needs to remember that there are 200 countries in the world. Amongst those 200 there are countries that are growing very quickly, like for example China, India, Brazil etc. This is why the OECD does not have the (moral) power, to impose itself on other countries. If the OECD tells China that it has to exchange information, China says, we are not members of the OECD. Why should we exchange information? What right do you have to ask this? This
is one of the problems. It is in those countries that there is very little exchange of information. Between the European countries there certainly is much more exchange of information.

Prof. Targetti: Let’s try to conclude, asking you to give us your opinion and vision of the future. If the process of globalisation, as I believe, will continue unabated, what fundamental modification with respect to the tax system as we know it today in the industrialised world, including China and India, will we be forced to introduce within the next ten years? I would ask you to limit your analysis to Europe, taking into account though that there are countries in the world with a billion inhabitants to which capital may flow. But as far as the 'European tax systems are concerned: What major changes will we be forced to introduce within the next ten years concerning the structure of the tax system, and also, I hope not but perhaps it is inevitable, form the point of view of the redesign of the system of social welfare.

Prof. Vito Tanzi: I will try to give a very quick and very short answer. First of all, perhaps ten years is not a very long period. In ten years we will more or less have the same discussion as today, with some small differences. However, the general direction in which we are moving – as I have analysed in other papers – is almost certainly that the fiscal burden will be forced down, especially in Europe. I believe that ten years from now it will be impossible for Italy to have a fiscal burden of 42% of GDP. For France it will be very difficult. In fact there has been much pressure on those countries to cut taxes and these pressures will become much stronger. Hence the first change that needs to take place is to rethink the role of the state in the economy; to rethink what can be cut. Expenditures would need to be cut but not by simply given fewer funds to some ministries without changing the laws and the task of the state, but effectively changing the role the state should play in the economy. Let us not forget that a hundred years ago the state made do with about 12-13% of GDP, that was the tax burden around 1900-1910. Hence expenditure can be cut without abandoning the tasks the state should assume like protecting the poor, and truly protecting people against risks the market cannot provide insurance against. This is the first point I would like to make.

The second point is that tax systems probably will have to be simplified a lot. Perhaps company taxation will disappear sooner or later, or will be transferred, if possible, to an organisation that can impose company taxes on a global scale. Probably the taxation of consumption like the VAT will play a much more important role. In the United States the flat rate tax has been discussed for quite some time now. The flat rate tax in essence has the same base as the VAT. Probably investment incomes will be taxed directly at the source, i.e. when incomes are paid. This system will become
much more widespread and therefore the administration will become much simpler. When a Swiss bank makes a payment it can directly withhold the taxes, probably there will be an levelling out of these withholdings at the international level. Beyond that it is difficult to discern exactly what will happen. Let us hope that we are not going into the direction of tax degradation, line in the example I mentioned before of taxes on cheques, that worries me a bit.

Prof. Tomasso di Tanno: In my view in the area of taxation, as in other fields, there are no prospects of an autonomous Italian course outside of the European context. Thus we cannot but follow, in some cases improve Eu legislation with local characteristics, but I have the impression that we cannot afford not to follow the direction the other European countries take. The specific task I would reserve for Italy is, once again, to improve the functioning of the Italian public administration in general, and of the agencies that deal with financial matters in particular. By the latter I mean not only the internal revenue service, i.e. not only that part of the administration which is charged with collecting tax revenue, but also the part of the administration responsible for relations with the private sector, the administration of the treasury. And this for the simple reason that the functioning of the state is increasingly considered an effective competitive element in international competition. States in which the administration functions well probably do not perceive this element of competitiveness, but In Italy it is increasingly evident to the extent that every time one participates in a international bid or competition, the support of the national state, in the end makes the difference.


