

Peace and Low Taxes

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Economic development has been historically associated with the fulfilment of two major conditions: a) Peace and b) low taxation. Peace was the necessary component for prosperity from the point of view of foreign policy. Empires, kingdoms, duchies, principalities and republics have been prosperous only as long as there has been peace. Low taxation was the necessary component from the point of view of internal policy. The historically unprecedented prosperity that mankind has experienced during the seventy-three years that followed WW II was marked by both peace and by low taxation.

While existence of peace in the developed part of the world has been a more or less obvious reality, low taxation was not as obvious. Namely, most countries had high nominal tax rates. This however **does not mean** that the developed world did not have in reality low taxes during the post-WW II era. Developed countries may have very well had high nominal tax rates, but the effective tax burden was not respectively high. As a matter of fact, low taxation was well hidden behind tax avoidance and in most cases behind international tax avoidance. This was happening for both business taxation and personal income taxation.

It was easy and lawful to become rich and at the same time pay low taxes. Even politically it was not so difficult, as tax avoidance had a big political advantage: while governments could pretend to their electorate that they follow the dominating socialist or quasi-socialist maxim that "the rich pay more taxes" by imposing high nominal tax rates, at the same time they were - in most cases consciously - tolerating countless tax avoidance schemes. As richer people and bigger enterprises were expected to pay more taxes, they consequently had a much higher tax savings potential than less rich people. As a result, tax avoidance schemes were allowing bigger enterprises and the most financially successful citizens to pay much less taxes than the nominal tax rates were supposed to impose.

In this way, everybody was happy: politicians could pretend to their electorate that "the rich" were indeed (supposed) to pay more, while "the rich" themselves were paying less than they were supposed to - and usually in a lawful way. "The rich" themselves were paying less than expected. And while the electorate could somehow perceive the truth, they did not complain much, as governments were generous enough regarding spending of tax revenue, which, despite tax avoidance, was more abundant than ever.

As the global financial crisis erupted in 2008-2009, soon followed by the Eurozone crisis of 2010, which is still not over, most governments suddenly saw themselves obliged to increase tax revenue without reducing the financial benefits of the electorate beyond a politically critical level. How would they achieve this? Combatting tax avoidance suddenly seemed to be astonishingly easy and, at least seemingly, financially promising.

Tax avoidance, an issue discussed until then mostly among experts, suddenly became a big political evil, causing headlines in the international press.

Tax havens, which were mainly small countries around the globe with stable legal and political systems, had become in the post-era world extremely prosperous by making themselves tax-free areas for non-residents, practically without any protests from the bigger countries. Such countries were persuaded almost overnight to disclose all necessary financial information to bigger countries and to change their tax and legal systems to the necessary extent. But no one wondered: if it was so easy after all to convince tax heavens to co-operate, then why did nobody even try to achieve the same result before?

The short answer is that governments simply had not wanted to put pressure on multinationals and on the richer citizens. As described above, they were happy with the situation of pretending to impose high taxes on the rich, while they didn't.

It should not be underestimated that a silent equilibrium of power between governments and taxpayers played a major role in keeping the overall effective tax burden low. Such equilibrium was usually not the result of deficiencies in democracy, but rather of the consciousness that the effective tax burden should not be too high, in order to allow "the rich" to keep making and spending their money in their home country.

Under this point of view, it is not surprising that while anti-avoidance rhetoric and actions become increasingly strong, nominal tax rates across the developed part of the world constantly fall.

One may wonder, whether such natural equilibrium can keep effective tax burden low enough in a natural way. If so, then there would be no reason to worry. In any way, we should let full transparency dominate in defining the true tax burden of all taxpayers.

There would be, however, many good reasons to keep "good old" tax avoidance practices alive.

- a) If something works - in the sense that it brings prosperity -, then we should rather not tamper with it.
- b) As long as lawful tax avoidance tools were available to the taxpayers, governments did not have unlimited financial leverage over them. As a matter of fact, lawful tax avoidance guaranteed a space of freedom, which governments can hardly be trusted to provide.
- c) Rising of populism in many developed countries may bring to power governments who will be tempted to break any unwritten financial equilibrium for the sake of temporary electoral gains.
- d) Anti-avoidance legislative and administrative practices will not actually increase effective tax revenue. In the "good old days" of tax avoidance, taxpayers were relocating profits in an artificial way. Now they will start relocating their activities and their active profit-making. People will relocate themselves and not just their profits to low tax jurisdictions. Relocation of activities will finally lower the prosperity of the entire society.

Last but not least: Growing scepticism towards the once warmly welcomed OECD BEPS-programme might finally damage, instead of boost, the ability of governments to collect taxes, by depriving them of what was supposed to be their ultimate weapon in the eternal struggle between governments and taxpayers.

It would be much better to allow this eternal struggle to evolve in a natural way, rather than pushing things in a way that radically questions the fundamentals of international tax law as they evolved over the course of 100 years of evolution and inherent improvement.