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Complexities of Global Taxation System & Resulting Tax Reforms

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Abstract

With Globalization,integration of world economy, trade and commerce is taking place. But the ease of trade and commerce is not as smooth as it seems to be because though we have transformed companies into Multinational corporations, but failed to ensure that our international tax system is fit for globalised world economy. It is cumbersome to operate in each country and the operational efficiency is hampered due to complex and heterogeneous taxation mechanism of multiple countries. Time, money, and mental pain spent by taxpayers in order to comply with the tax system increase due to heterogeneity of global taxation system. Increased complexity of organisations, cross-country investments andacquisitions areleading to more complex tax rules. Eagerness of different countries to invite foreign investments, globalisation of economies, free trade agreements and tax treaties etc. further add to these complexities.

The present paper focuses on the analysis of taxation mechanism of different countries and operational inefficiencies that occur due to this heterogeneity and the reforms taken to simplify this taxation complexity.To make the international tax laws more compliance friendly, comprehensivereforms are being made in the tax laws all across the globe.

Keywords: globalization, reforms, tax

Introduction

"Beginning together, continuing together, and succeeding together are the three pillars of success. “No one can succeed alone. The same applies to the economies. Every nation excels in one area while falling short in another. This leads to the integration of economies to satisfy the unfulfilled needs. This interaction of one economy with the other gave us the concept of globalization. The central feature of globalization is an economic process of interaction and integration of social and cultural aspects.

Globalization is a movement that aims to integrate trade, finance, commerce, and communications on a global scale. Broadening the regional and nationalistic perspectives to a more global vision of an interconnected and interdependent world with free circulation of capital, products, and services across national boundaries brings in many benefits that can be availed by the integrated economies i.e. increase in employment, production, improved standard of living, increased income etc. However, there are some areas that are making it difficult for the corporate organizations to operate on a worldwide scale. Tax is one such area that complicates the working procedure. International taxation system influences the volume as well as location of foreign direct investment and is responsible to a great extent for tax avoidance (Gordon & Hines Jr, 2002).

Taxation system is not just the combination of two words " taxation +system" rather in itself it is a deep discipline which highlights different areas of specialization (GST, Income Tax, Corporate Tax) to be handled in a legitimate manner. Every country has its own taxation system which is distinct from the other. Different countries in the world use different tax systems. Most widely used tax system (used by more than 130 countries) is residency-based taxation in which personsare liable to pay tax ifthey become a tax resident in a country. Then, there are some tax haven countries like Bahamas, Cayman Islands in which foreign investors pay zero tax or nominal tax. A few countries like Malaysia and Panama use territorial- based taxation system in which only income actually generated inside the country is liable to tax. Only two countries - United States of America and Eritrea use citizenship-based taxation system in which their citizens have to pay taxes irrespective of the place they are residing.

Companies operating in several countries are subject to different tax rates as well as different tax regulations. Such companies face multitude of potential tax obligations due to this diversity (Blouin, 2011). Each country's tax system is unique with regard to overall tax burden, tax base and taxpayer, and decentralization. This heterogeneity in the tax system magnifies the complications for the global organizations (Pippin, 2020) . Hoppe et al. (2021) introduced a new concept of Tax Complexity Index (TCI)composed of two sub-indices- the tax code and the tax framework subindex to assess the income tax complexity faced by MNCs using survey data of 100 countries. They found considerable variation in the overall level of tax complexity across countries.

Consequently, this study has been conducted firstly, to identify the operational inefficiencies caused by tax heterogeneity. Secondly, to get an insight of the tax reforms taken to curb the tax complexities.

Objectives of the Study

- To identify the operational inefficiencies that occurs due to heterogeneity of taxation system.
- To get an insight of the tax reforms taken to curb the tax complexities.

Analysis & Interpretation

Different countries in the world are found to be at different stages of development. World Bank classified countries into four categories i.e., low income, lower middle income, upper middle-income, high-income economies depending upon the stage of development. For 2022-23, the classifications is based on GNI per capita in current USD (using the Atlas method exchange rates) of the year 2021.

Low-income countries - GNI per capita is US $ 1085 or less.

Lower middle-income countries- GNI per capita is between US $ 1086 to US $ 4255.

Upper middle-income countries- GNI per capita is between US $ 4256 to US $ 13205.

Higher income countries - GNI per capita is more than US $ 13205.

Few countries from each category are selected to analyse the taxation mechanism across the globe. In order to have a glimpse of taxation mechanism and to simplify the analysis only tax rates are taken into consideration.

Table 1: Country wise tax rates

S. No	Name of Country	Category	Corporate Tax (%age)	Income Tax (%age)	Sales Tax/VAT/GST (%age)
1	**Afghanistan**	Low-income Country	20	0-20	10
2	**Sudan**	Low-income Country	35	15	17
3	**Bangladesh**	Lower middle-income country	30	0-25	15
4	**India**	Lower middle-income country	30	0-30	0-28
5	**Pakistan**	Lower middle-income country	29	0-35	17
6	**Brazil**	Upper middle-income country	34	0-27.5	17
7	**China**	Upper middle-income country	25	0-45	13
8	**South Africa**	Upper middle-income country	27	0-45	15
9	**Australia**	High income country	30	0-47	10
10	**New Zealand**	High income country	28	10.5-33	15
11	**United Kingdom**	High income country	25	0-45	20
12	**United States**	High income country	25	10-37	2.9-7.25
13	**Japan**	High income country	23.2	5-45	10

Source: Worldwide VAT, GST and Sales Tax Guide 2022 EY Global

From the data given in table 1 it is evident that there are little similarities amongst the countries in context of tax rates. Even in intra category, tax rate differentiation is the centre of concern for the corporations. For instance, India and Pakistan both lie in the category of "lower middle-income countries" but the rate of taxes is not at all similar. For instance, corporate tax varies between 25-30 % in India, whereas in Pakistan corporate tax is charged at a flat rate of 29%. Tax rate is only one aspect of taxation system. There are many other factors which should be considered by companies before entering into new countries to expand their market share. These factors include number of return, provision of advance tax, tax deducted at source etc. This difference in the provision of taxation system brings complexity in the taxation system. So, in a nutshell it can be said that taxation mechanism is complex and should be handled with due care as it affects the company from incorporation to liquidation.

Operational inefficiency

In a business context, operational efficiency can be defined as the ratio between an outputs gained from the business and an input to run a business operation. When the output to input ratio improves, operational efficiency is improved, and when the output gained is reduced to the input used, it represents the operational inefficiency. Taxation system of different countries differs from each other. This heterogeneity in taxation system forces companies to make differentiated strategic taxation plans for different countries. This not only consumes a lot of time and effort but increases the operational cost. The key areas that lead to operational inefficiency are:

1. Returns: Return is form on which a taxpayer makes an annual statement of income and personal circumstances, used by the tax authorities to assess liability for tax. Different types of returns (Income tax return, GST return) are filed by taxpayers depending upon nature of transactions. Every country has its own format of return. None of the country share same format of return. The complexities related to return includes the following.

1.1 Choosing the appropriate return - Different type of returns are used for direct and indirect taxes in different countries. Selection of applicable return is one problem. Secondly return opted in one country cannot be used in other country.For instance, in India 7 return forms are used for income tax, in America there are 10 forms and in Bangladesh total number of income tax return forms is 11.

1.2 Timing of filing return - Within in the same country there is a lot of difference in the timing of filing the return. Some returns are filed quarterly some by-annually and some annually. Income tax return in India is filed annually whereas GST returns are filed monthly, quarterly and annually. Timing of filing same type of return is also different in different countries. In India income tax return must be filed by a corporate assessee on or before 30 September/30 November; in New Zealand return must be filed till 7 July and in Brazil it must be filed by 30th April of next year.

1.3 Attached conditionality- Return is to be filed in the prescribed format. In some countries returns are to be filed in the paper form and in some they are to be filed in electronic form. In India returns are to be filed electronically whereas in Afghanistan they are filed manually.

2 Human resource complexities: Tax structures of countries directly affect the human resource management in a company. It affects in the following ways

2.1 Diversified employees - Every country has its own taxation mechanism. Therefore, the requirement of organisations in terms of employees will diversify. In every country they will have to appoint different professionals (CAs, Lawyers), who are well versed with the legal and technical complexities of the respective countries. So, the appointments can't be made at the head office level. It will lead to duplication of work and increase the cost.

2.2 Diversified pay packages – Salary of an employee not only motivate them to perform efficiently and effectively rather it is also considered while tax planning as salary is treated as a deductible expense while calculating taxable business income. Uniformity in the pay packages can't be maintained as tax treatment of allowances and perquisites, which is part of pay package is different in different countries. Moreover, the provisions of TDS (tax deducted at source) are different. This requires a lot of revision and moderation in salary packages. Every time company moves to a new country, they have to plan salaries again. It leads to wastage of time and money.Fringe benefits tax used to be charged at 30% in India till AY 2009-10. It has been abolished from AY 2010-11. Whereas in New Zealand it is charged under three options i.e. Single rate (49.25%), Short form alternate rate (49.25/42.86%) and Full alternate rate.

3 Tax Planning and Management - Tax planning is a systematic arrangement of numerical transactions in a legal way that leads to reduction in tax liability. Under tax planning rebate, relief, exemptions, deductions etc. are used to reduce tax liability. However,the tax management is concerned with tax compliance and the payment of the taxes on time. Since every country has its own taxation system, every time companies move to a new country, they have to plan taxes in a new way. For instance,advance taxes are paid in India if tax liability on assessed income is ₹10,000 or more during the financial year. Whereas in Nepal advance tax is paid, incase tax liability on assessed income is ₹ 5000 or more during the financial year.

4 Repatriation of Profit - One of the main reasons to globalise is to increase profit. Every company wants to explore a country which provides higher profit. Profit can only be repatriated after the payment of taxes. Higher the rate of tax, lower the amount of profit to be repatriated. As exemplar in India foreign companies can repatriate profit via dividend, buyback of shares, reduction of share capital, fees for technical services, consultancy service/business support services and royalty. On dividend paid to non-resident shareholders, tax at source is to be deducted @20% (plus surcharge, if applicable and cess), subject to availing of DTAA benefit. In case of buy back of share Buyback tax @ 20% is paid on profit distributed by company to shareholder. Whereas in New Zealand default rate of NRWT (Non-Resident Withholding Tax) on dividend paid to off shore parent company varies between 0%- 15% depending upon ownership.

Tax Reforms Adopted by the Countries across the Globe:

Heterogeneous tax mechanism is one of the major obstacles faced by global corporation. Management of this heterogeneous system consumes a lot of time and money. Government of each country is aware of the benefits which they derive from taxes as well as from global corporation. In order to simplify the tax mechanism, the government of each country has been adopting one or the other tax reform to provide ease of doing business to the global corporations. Major reforms adopted by different economies are:

1.Regional Economic Grouping: it is a process in which neighboring states enter into an agreement in order to upgrade cooperation through common institutions and rules. It focuses on removing barriers (tariff and non-tariff) to free trade in the region, increasing the free movement of people, labour, goods and capital across national borders. Through these integration companies from neighboring states gets an opportunity to enter into new market through reduced or no taxes. Following table represent the different type of economic grouping across the globe:

Table 2: Regional Economic Groups

S. No.	Type	Name	Number of Member States
1	Economic &Monetary Union	European Union (EU)	27
3	Custom &Monetary Union	Economic Community of Central African States (ECCAS)	11
4	Common market	Association of Southeast Asian Nations (ASEAN)	10
5	Customs Union	Andean Community	4
6	Multilateral Free Trade Area	North American Free Trade Agreement (NAFTA)	3

Source: Compiled by researchers

2.International Tax Treaties/DTAAs - When an individual or business invests in a foreign country, the issue of which country should tax the investor's earnings arises. If both the countries tax the income then the problem of double taxation arises. In order to avoid this situation, the source country and the residence country – may enter into a tax treaty to agree on which country should tax the investment income. An international agreement to avert the double taxation of passive and active income is known as a tax treaty. Tax treaties normally define the amount of tax that a nation may impose on a taxpayer's incomes, assets, estate, and wealth.

A tax treaty is also called a Double Tax Avoidance Agreement (DTAAs). By satisfying the attached preconditionsa relief from double taxation can be claimed. Except tax havens majority of countries in the world have signed these international tax treaties. Following are the main advantages of DTAAs.

2.1 By taking into account the unique tax rules of the two nations, DTAAs preclude double taxation (the two countries in the case of a bilateral DTAA).

2.2 Tax information interchange is frequently offered under DTAAs.This tax exchange information lowers the administrative costs of taxation.

2.3 Another advantage is that there is legal certainty in DTAAs as there are specific rules for taxing international income. Foreign investment in emerging nations stimulates because of tax certainty.

2.4 DTAAs' also incorporate anti-abusive provisions to ensure that the benefits of the DTAAs are availed by the genuine residents of the two countries.

Investors no longer have to rely on heterogeneous national tax laws because DTAAs govern how international income istaxed.Table 3 portrays the treaties entered by different countries. For this purpose eightcountries have been randomly selected.

Table 3: Tax Treaties Entered by DifferentCountries.

S.No.	Country Under Consideration	Number Of Countries
1	India	96
2	United States	69
3	Australia	54
4	United Kingdom	153
5	China	112
6	New Zealand	40
7	Brazil	39
8	Pakistan	66

Source: Compiled by researchers

From table 3 it is clear that an Indian concern can easily work with other 96 countries without being worried about double taxation.

3.Advance Pricing Agreement – One of the disputed issues in taxation related to MNCs is the area of intra company transactions. The pricing of goods and services between two related companies is called transfer pricing. It is sometimes used as a tool to avoid taxes by keeping prices higher. To avoid these manipulations, advance pricing agreements are used. APA is a contract between a tax payer and at least one tax authority specifying the pricing method that the tax payer will apply to its related company transactions. It is of three types; unilateral, bilateral and multilateral. It brings following advantages to both the parties:

3.1 It gives certainty to taxpayer indetermination of transfer pricing and amount of taxes to be paid to the government.

3.2 It reduces the chances of disputes thus helps in avoiding litigation cost and compliance cost over the term of APA.

3.3 For contracting country, it helps to increase tax revenue, reduce cost of administration and makes the country an attractive destination for foreign investment.

4.Goods and Service Tax (GST): The Goods and Services Tax (GST) is an indirect tax applicable on the supply of goods and services with few exceptions. It replaces multiple indirect taxes -central excise duty, additional customs duty, VAT, entertainment tax, service tax, etc. levied by governments in order to simplify the indirect tax system. France was the first country to introduce GSTin 1954. At present GST is applicable in more than 160 countries.Some of the countries with GST include Canada, Vietnam, Australia, Singapore, U.K., Monaco, Spain, Italy, Nigeria, Brazil, and South Korea. India implementedGST on July 1,2017. In a country where GST is applicable, it saves multinational companies from the hustle bustle of planning for multiple indirect taxes.

5.Two Pillar Plan: Two pillar plan is the latest international tax reform to address the problem of base erosion and profit shifting (BEPS) and to ensure the suitability of international taxation system in a globalised world economy. BEPS is a tax planning strategy used by multinational companies to avoid paying taxes by exploiting the loopholes, gaps and mismatches in tax laws. In October 2021, 137 countries and jurisdictions working on the implementation of 15 initiatives under the OECD (Organisation for Economic Co-operation and Development)/G20 Inclusive Framework on BEPSjoined a Two Pillar Plan to combat tax avoidance, enhance the uniformity of international tax legislation, and promote a more transparent tax environment.According to OECD, these rules would become effective in 2023.

5.1 Pillar 1: Pillar 1 focuses on rules for taxing profits and rights, with a formula to calculate the proportion of earnings taxable within each relevant jurisdiction. Its purpose is to ensurea fairer distribution of profits and taxing rights among relevant jurisdictions. It will apply to big multinationalcompanies with annualglobal turnover of over 20 billion eurosinitially (later on to be reduced to 10 billion euros), and profitability above 10%.

5.2 Pillar 2: Pillar 2 imposes a minimum tax rate of 15%referred to as GLoBE (Global Anti-Base Erosion) tax on income arising in each relevant jurisdiction in which they operate to discourage companies from shifting profits to lower-tax countries through international trading structures. The minimum tax will apply to MNEs with annual global turnover of over 750 million euros.

Keeping in mind the fact that OECD cannotchange domestic legislation in any country, each member country must develop their own domestic policy and legislation to ensure the effective implementation of this major reform

Conclusion

Globalistion is need of hour. It brings better avenues for the development of organizationsand countries. Moving beyond the borders poses a lot of challenges for the organisations. The taxation system plays an important role in accelerating the economic development of a country. Heterogeneous taxation mechanism of different countries is one of the major obstacles faced by global organisation. It augments the cost of entering the new countries or markets. Government of every country is aware of the benefits of multinational corporations. To attract more companies to their territories, they are making different reform in their taxation system i.e. introduction of GST, DTAAs' etc. to make it compliance friendly. The focus should be on

simplification of taxation system along with other continuous reforms. Compliance with tax laws is important to keep the system working for all and to encourage compliance, it is necessary to keep the tax rules as clear and simple as possible. Overcomplicated taxation systems often result in high tax evasion and avoidance.

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