Hacienda Pública Española/Review of Public Economics 255-(4/2025): 3-9

INTRODUCTION

Special Issue
"Time for a Real Tax Reform-2025"

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These are challenging times for government policymakers. Fiscal systems are gradually recovering from the COVID-19 pandemic, but relatively high public debt and deficit levels persist. Addressing them is complicated by many persisting and emerging factors. Two issues are dominant. One is the slowdown in productivity growth rates, which reduces the automatic increases in tax revenues that many countries have relied on to finance improvements in the level and quality of public services and transfers. The other is the gradual increase in inequality of incomes and in the relative share of capital to labour income. The result is growing wealth inequality, with a high proportion of wealth being owned by relatively few super-wealth individuals. This leads to a polarized society with less privileged persons facing falling living standards and opportunities and wealthy persons seemingly able to exercise an unhealthy amount of influence on the political process.

Besides these issues of sluggish productivity and growth in inequality, several other important concerns have been stressful on the public finances. Population aging in OECD countries has increased the demand for public services. Some of this has been mitigated by immigration of young, skilled persons, but many migrants are refugees or low-skilled workers who are fleeing their home countries to avoid persecution and in search of a better economic life. Labour markets have faced various structural changes such as higher female participation, increases in demand for high- relative to low-skilled workers, and displacement of workers through digitization and artificial intelligence (the effects of which have only just begun to emerge). Some of these changes were due to the globalization of markets, which caused some countries to resort to protectionist policies to prevent the loss of skilled jobs. This has led to a disruption of world trade patterns as well as considerable uncertainty which in turn has discouraged the investment needed to foster economic growth. The globalization of capital markets has led both to tax competition that discourages taxation of capital income and to tax avoidance and evasion activities that reduce the ability of governments to raise revenue from mobile capital and labour. Finally, the green transition will have fiscal implications as governments support infrastructure investments needed to substitute away from fossil fuels.

Tax policies have an important role to play in addressing these issues. Managing fiscal deficits and lowering public debt levels require, at least in part, mobilization of tax revenues. These can come from some combination of changes in the tax mix, broadening bases, increasing rates and improving compliance. An important source of revenue generation is the value-added tax, which has become a significant component of the tax mix in most countries over the past few decades. Its broad base means that large amounts of revenue can be raised from given tax rates. As well, it focuses on consumption so does not discourage saving. The VAT can be accompanied by a refundable tax credit to low-income persons to prevent adverse redistributive effects. There is some scope for base broadening by reducing the number of tax-exempt items from tax.

Incremental tax revenues can also result from higher growth rates and green tax revenues, which themselves are sensitive to tax reforms. Increases in national growth rates rely on new investments especially in productivity-enhancing projects, including R&D and human capital investment. Investment and savings friendly reforms of corporate and personal tax systems can be growth-enhancing. Tax incentives can be sparingly applied to encourage production activities that generate externalities, such as transferable knowledge, learning-by-doing and agglomeration effects. Carbon taxes can be designed to address greenhouse gas emissions.

Tax reforms can remove inefficiencies of existing systems that lead to deadweight losses. These include simplification of the tax system, as well as improvements in tax administration that encourage compliance. Special attention must be given to digital and high-tech industries whose output consists largely of information flows that are by nature difficult to tax. Some tax reforms will require international cooperation to preclude profit shifting and wasteful tax competition.

At the same time, the tax system is a key instrument available to address income and wealth inequality and foster equal opportunities for persons regardless of their backgrounds. The personal income tax is the main instrument for redistributing income, and both the choice of base and rate structure are relevant. Of particular importance is the treatment of capital versus labour income since proportion of income consisting of capital income is increasing in income. As well, capital gains make up a higher proportion of capital income for higher income persons, and for administrative reasons capital income is typically taxed only when it is realized. Higher income persons are able to shelter much of their income as unrealized capital gains. The corporate tax complements personal taxation by taxing capital income at source which would otherwise be sheltered within the corporation. The rate structure is also important, but it is constrained by disincentive effects associated with high marginal income tax rates.

Other tax instruments are available to reduce wealth inequalities. A tax on wealth does so directly and can also tax unrealized capital gains that would otherwise go untaxed. There are constraints to using wealth taxation. Some are administrative, such as the difficulty of evaluating wealth annually or preventing avoidance responses. Others are conceptual, such as the fact that wealth taxation partly double taxes capital income that is liable for personal taxation. An alternative to a wealth tax that tackles much of the wealth inequality at its source is a tax on inheritances. Such a tax often faces public opposition and also may encourage out-migration of the wealthy, which restricts its use as a redistributive device.

Historically, tax structures have been slow to change. The basic form of personal and corporate income taxes structures have been in place now for most of post-war period. The benchmark for personal income tax is the comprehensive income tax with the rate structure serving both horizontal and vertical equity purpose. The corporate tax is meant to complement the personal tax. By taxing at source income that would otherwise be sheltered in the corporation. The exception is the VAT, which gradually came to be one of the major revenue sources for most OECD governments in the past few decades. Tax reform commissions in many countries have advocated major changes to the tax structure, especially involving preferential treatment of capital versus labour income and proposing progressive taxes on inheritances received. Some have also called for a shift in the corporate tax away from a withholding device for the personal tax to a standalone tax on economic rents or pure profits.

Despite the many calls for fundamental tax reform, most reforms apart from VAT introduction have been fairly incremental. Adjustments to the income tax base have mainly involved giving preferential treatment to capital income (including pensions). Changes to the rate structure have been more common, mostly flattening the frate structure and reducing rates in response to international competitive pressures.

An outstanding question remains: To what extent can tax reform address the many pressing problems facing countries today? This special issue is a step in that direction. The developments outlined above there emphasize the many challenges facing policymakers, some of which can be addressed by effective reforms of the tax systems. The challenges highlight the importance of carrying out careful empirical, leveraging the vast data offered by digitalization, and theoretical analyses that shed light on tax reform, and on how policymakers might best take advantage of them. The measurement of taxpayers' responses to diverse taxes, including enforcement policies, should inform the optimal design of taxes. The mix of papers in this special issue reflect progress that has been made in designing and implementing tax reform that will improve both productivity growth and redistributive fairness and do so in an administratively efficient way.

The articles in this Special Issue tackle many of these broad issues of tax reform. Among the issues they consider are the economic basis for tax reform; its effect on efficiency and growth, and its consequences for income and wealth redistribution; the design of specific tax reforms, including to the personal income tax, corporate taxation and wealth taxation; the political constraints and opportunities for tax reform; the importance of tax administration and how it can be improved; problems surrounding tax compliance, including tax avoidance and evasion as well as inadvertent non-compliance due to the complexity of the tax system; and implications of digitization and emerging technologies for tax design and reform. Taken together, these articles should be valuable both for scholars of tax policy and policymakers.

The article by Jorge Martínez-Vázquez is a comprehensive analysis of the forms and feasibility of tax reform, the obstacles to comprehensive reform, the optimal timing of tax reform and the effect of technological change on tax reform needs and possibilities. He considers both the economic arguments for objectives of tax reform that are informed by conventional public economic arguments, and the political and institutional conditions that facilitate or become obstacles to effective reform. He distinguishes three types of tax reforms and their combination:

reforms intended to increase tax revenues, reforms to improve the efficiency of the tax system, and redistributive tax reforms. He places special emphasis on reforms to increase tax collections as percent of GDP. He argues that successful tax reform involves two main and clearly separate types of activities: the process –how to do tax reform –and the substance –what tax reforms to pursue. He emphasizes that actual tax reform objectives and feasibilities vary among countries as well as between industrialized and developing countries. He documents this by carefully summarizing the kinds of tax reforms that have been successfully implemented internationally. He states that the main objective of his article is to elicit lessons for policymakers from two dimensions of tax policy and tax administration reform: the political economy perspective and the technical (nuts and bolts) perspective. His paper covers a very wide variety of tax policy topics including the political economy of tax reform, including setting out detailed objective, the role of medium –and long– term strategies and of obtaining broad support for reform especially among losers; analytical and empirical support for tax reform; the use of tax incentives, tax expenditures and presumptive taxation; selective issues such as minimum corporate taxes, wealth taxes, carbon taxation, taxation of natural resources, and financial transactions taxation. Finally, considerable attention is devoted to tax administrative issues, such as tax compliance and enforcement, social norms, tax amnesties, and the choice of institutions for administering taxes.

The next two articles look more specifically at two issues emphasized by Martínez-Vázquez, tax administration and international tax compliance. The article by James Alm explores the necessary link between tax reform and tax administration, and he provides much useful practical evidence-based advice on what conditions lead to successful reforms. He suggests three complementary paradigms that lead taxpayers to pay their legal tax liabilities. One is the standard enforcement paradigm that emphasizes achieving tax compliance through the probability of audits and tough penalties. The second he refers to as the service paradigm. It suggests that the tax administration has a supporting role as a facilitator and a provider of services to taxpayers, including assisting taxpayers in the filing of their returns and paying taxes. The third paradigm, called the trust paradigm, is less well defined but equally important. It recognizes that taxpayers are social beings whose behavior depends on their own moral values as well as those of fellow citizens. Tax administrators and the government can engender social trust and norms by convincing taxpayers of the quality, credibility, and reliability of the tax administration and belief in the trust of other taxpayers.

As a prelude to discussing these paradigms in detail, Alm briefly summarizes the determinants of compliance, including especially the effect of audits, penalties and tax rates as well as the effectiveness of providing information to taxpayers about the tax collecting process and the tax system itself. He emphasizes the importance of information technology and digitization for the efficiency of tax administration, including recent advance in public-key cryptography, blockchain technology, and artificial intelligence. He then discusses the reasons for tax reform and the factors that contribute to a successful tax reform. The reasons include raising additional revenue, broadening and simplifying the base, addressing horizontal and vertical equity shortcomings, improving efficiency and reducing tax avoidance and evasion. He summarizes some lessons from past reforms, many of which are consistent with those discussed by Martínez-Vázquez. These include the need to tailor reforms to the distinct circumstances of the country, the need for a well-articulated plan, the importance of leadership and of policy advisors engaging in political dialogue, the relevance of timing and the transition, the desirability of supporting empirical analysis, and the need to take account of both the intergovernmental and international dimensions.

Of special relevance for the success of a tax reform is accompanying it with reform of the tax administration. Alm argues that three broad ingredients of a successful administration reform are political will, a careful plan and adequate resources. He discusses in detail some specific properties of successful tax administration reforms. He reiterates that reform cannot be limited to the so-called enforcement paradigm: it must also address the service and trust paradigm. Examples show how reforming the process of identification, collection and enforcement would enhance detection and punishment. At the same time, tax services could be more user-friendly by treating the taxpayer more as a client than a criminal. Most emphasis is put on government-led reform to improve the culture of paying taxes. For example, government communications could stress the reciprocity necessary to improve trust in government and to show that it supports citizens in living better and more fulfilling lives. Alm suggests several national policies that affect trust, such as reducing inequality and discrimination, reducing corruption, improving the social safety net, enhancing economic growth and being transparent and accountable. Local government strategies can also improve trust in government more generally.

Alm concludes by reiterating his two main messages. First, successful tax reform requires supporting tax administration reform. Second, successful tax administration reform goes well beyond changes in detection and enforcement policies.

The paper by Athanasios G. Vasilakis and Vasileios Vlachos uses a meta-analysis to review the determinants of base erosion and profit shifting –so-called BEPS– at the country level. The size of BEPS is important because it reflects how much tax revenues countries are liable to lose as multinational corporations shift their profits to low-tax jurisdictions both by moving economic activity and by accounting methods. Their meta-study focuses on the macro-effects of BEPS, studying the literature and identifying gaps for future research. They distinguish between the periods 2003-2013 and 2014-2024. The BEPS Actions Plan was introduced by the OECD in 2013, followed in 2015 by 15-point OECD Inclusive Framework on BEPS whose main element was a minimum 15% tax on large multinational enterprises (called Pillar Two). In all, 138 countries joined OECD Inclusive Framework on BEPS.

The study relied on peer-reviewed articles and government/commission report, with particular emphasis on corporate tax rates, tax base erosion, and their implications for tax revenue. The emphasis was on EU tax policy and its relationship with BEPS. Common dependent variables found in the literature were profit-shifting, tax revenues, real and phantom foreign direct investment, the corporate tax rate and base, tax haven status and profits. Common independent variables included foreign direct investment, the corporate statutory and effects tax rate, competitor tax rates and GDP.

The authors found evidence of several general results. Traditional tax incentives became less effective and were undermined by profit shifting. The global minimum tax reduced tax competition, even though not all countries adopted it. Multinational enterprises reallocated their investment to low-tax countries, facilitating profits shifting. There was tax base erosion observed in both developing and high-tax countries. BEPS policies showed mixed effects. The existing literature on BEPS has largely overlooked the impact of effective tax rates on both real and phantom foreign direct investment, as well as on immediate and ultimate foreign direct investment.

The authors conclude with some policy observations. In the pre-2013 period, policy solutions were scarce. There was more emphasis on problems of profit shifting and tax competition. Subsequently there was a movement from acknowledging a problem to pursuing solutions. In particular, optimism for policy solutions changed post-2014 with OECD BEPS strategy, especially optimism over global agreement on 15% minimum tax, which was viewed as a game changing. Optimism was however damped by fact that some economies (e. g., USA) did not adopted Pillar Two. This has encouraged observers to look at alternatives like unilateral adoption of a minimum corporate tax rate and regional agreements.

The final two articles focus on two specific types of taxation whose effects are relevant for addressing the two main issues of efficiency and fairness. One is corporate taxation, which is a critical tax policy instrument both for influencing investment and growth, but also as a complement to the personal income tax to ensure that capital income is taxed efficiently and fairly. The other focusses on an innovative proposal for integrating wealth and income taxation to rationalize the taxation of capital income and wealth.

In their article, Ruud de Mooij, Shafik Hebous, and Alexander Klemm consider the future of the corporation income tax (CIT) in the wake of globalization and tax competition, the inefficiencies by the existing CIT, and the challenges imposed by digitization and artificial intelligence. They argue that many of these problems could be addressed by moving to a destination-based cash-flow tax (DBCFT). One the one hand, a tax on real cash-flows if designed properly would be equivalent to a tax on economic rents or above-normal profits. Such a tax would avoid the distortions of the existing CIT on investment and financing by corporations. It would also remove many of the incentives for the shifting of proficts to low-tax-rate countries and the tax competition that entails.

Specifically, by the aim of the CIT is to tax the equity income of corporations in pursuit of withholding shareholder income sheltered in the corporation. This necessarily entails discouraging equity-financed investment and encouraing debt finance. A cash-flow tax avoids this by taxing only above-normal corporate income and eliminating interest deductibility. At the same time, the CIT typically applies on corporate income at source, which involves taxing permanent establishments where they produce income. Such a system is susceptible to profits shifting and tax competition. More important, the source principle cannot be applied to digital and high-tech firms whose sales do not require permanent establishments. As the authors argue, a DBCFT avoid both the ineffiencies of the existing CIT by taxing rents, and the incentive to shift profits by effectively allocating tax liabilities by sales (analogous to a destination-based value-added tax).

In addition to making the case for a DBCFT, the authors consider some challenges to implementing it including the desirability of international agreement, transitional issues and the tax tratment of financial income. They also consider the implications of adopting a DBCFT for the appropriate taxation of capital income at the personal level, and they offer some interesting alternatives.

Overall, the view of the authors is that moving to a DBCFT, either one country after another or in a coordinated fashion, is both desirable and inevitable. Their analysis is quite compelling.

The article by Rubén Amo Cifuentes, Rafael Granell, and Amadeo Fuenmayor considers an innovative proposal for integrating wealth taxation into the existing income tax system in Spain. The proposal is inspired by a similar integrated wealth-income tax adopted in the Netherlands. Spain is one of relatively few countries that deploys an income tax and a wealth tax, but as the authors point out the design of the taxes compromises but efficiency and equity. Currently, the net wealth tax is levied by the autonomous communities separately from the income tax. In addition to the tax being susceptible to inter-community tax competition, its redistributive potential is compromised by exempting wealth held in family businesses and by its relatively low rates. Also, since it is a standalone tax, communities face dedicated administrative costs. The central government has enacted a backstop wealth tax to deter tax competition, but the wealth tax remains a separate tax uncoordinated with the income tax. At the same time, the income tax treats capital gains preferentially by including them only on realization. This detracts from redistributive objectives and is an argument for wealth taxation which does tax capital gains as they accrue.

The proposal is to integrate wealth and income taxes by a) taxing accrued capital gains on wealth that is not taxed by personal income taxation and b) taxing income from family business assets that are currently excluded from wealth tax. The net wealth tax and the central backstop would be abolished, and the dual personal income tax would be redefined so that capital income would be presumed income from net wealth of taxpayers and would be taxed progressively.

The authors use microsimulation to study the impacts of wealth tax reform on individual tax burden. Three scenarios are simulated: 1) replace the existing capital income tax base with one that includes accrued capital gains from wealth, while keeping exemption for family businesses and existing low tax rates for capital income; 2) eliminate the exemption for family businesses; 3) adopt the proposal in full. The simulations first estimate mechanical effects alone and then include behavioural effects based on tax base elasticities found in the literature.

In all scenarios, there is a mechanical increase in tax revenues whose size increases as one goes from 1) to 2) to 3). The average effective tax rate based on wealth shows no progressivity either in the current system or in scenario 1). Scenario 2) leads to some progressivity, especially at higher wealth levels, while scenario 3) is much more progressive. Adding behavioural effects reduces both the revenue effects of the reforms and the redistributive effects.