Cross-border taxation of companies - Trends, challenges and options for reform

Problem statement

Traditional allocation of taxing rights (OECD Model Convention)

- The **country of source** taxes **business profits** by way of corporate income tax and levies a withholding tax on **dividends** and **interest** at a **limited rate**
- The **country of residence** taxes **interest** and **royalties** by way of corporate income tax and may either **exempt dividends** or grant a **tax credit** for foreign corporate income tax

Globalisation

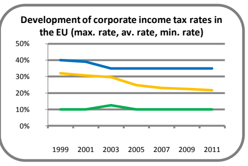
Mobility of capital and profits

Importance of multinational companies and intra-group trade

Difficulties to determine the source of profits

Tax policies aimed at attracting investment and profits

- Reduce corporate income tax rates
- Reduce withholding taxes on dividends and interest
- Introduce dividend exemption
- Specific tax regimes for holding or financing companies, and companies exploiting intellectual property



Jurisdictions adopt measures to protect the corporate tax base

- Thin capitalisation and earning stripping rules
- Controlled foreign company rules
- Transfer pricing rules and exit taxes

Issues:

- Double taxation
- Additional compliance and administration costs

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European law

- Interest & Royalty Directive and Parent-Subsidiary Directive limit the scope for withholding taxes
- Negative integration through ECJ case law may not resolve disparities resulting from unharmonised tax system

Research questions

How do recent developments affect the allocation of taxing rights?

To what extent are business decisions distorted?

What are options for unilateral and multilateral reform?

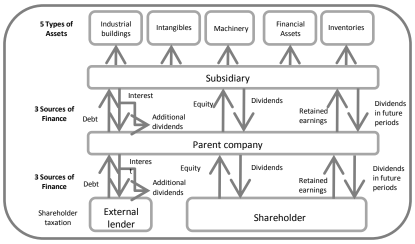
Procedure

1. Comprehensive survey

- Aim:
  - Investigate how cross-border taxation of business profits, dividends, interest, and royalties in the EU and selected OECD countries has developed
  - Focus on how anti-avoidance provisions influence the allocation of taxing rights
- State of research:
  - The basic case has been extensively dealt with in the literature.
    Amongst others Lang et al., 2008; Holmes, 2007; Stefaner & Züger, 2005
  - Various surveys on anti-avoidance provisions
    Amongst others: Gouthière et al., ET 2005; Bohn, 2009; Weber, TNI 2010; Zielke, Intertax 2010 (on TCR and comparable rules); Fontana, European Taxation 2006; KPMG 2008 (on CFC rules).
- Original Contributions:
  - Investigate the development over time since 1998 and whether countries follow different strategies
  - Identify trends in tax policy concerning the design of anti-avoidance provisions
  - Assume a broader perspective without focussing on one single kind of provision but taking into account how provisions interact.

2. Analysing distortions

- Aim:
  - Computing effective tax rates in order to identify distortions of business decisions in case of cross-border business activity
    Partly drawing on calculations conducted at the ZEW on behalf of the EU Commission
- Methodology:
  - Devereux & Griffith Model (Devereux & Griffith 1999, 2003)
  - Based on neoclassical investment theory assuming hypothetical investment projects



- Model enhancements:
  - Cross-border taxation of royalty income
  - Anti-avoidance provisions
  - Specific tax regimes aimed at attracting holding and financing companies as well as companies exploiting intellectual property (IP)
- Further possible contributions:
  - Asses to what extent the cross-border taxation is in line with the neutrality concepts CEN, CIN and CON (drawing on Elschner et al., PWP 2011)
  - Advancing the continuity approach by Schön (WTJ 2009 & 2010)

3. Evaluating reform proposals

- Aim:
  - Evaluating and advancing proposals to reform the cross-border taxation of companies
  - Discuss unilateral policy options as well as multilateral proposals
  - Deriving policy recommendations
- Evaluation criteria:

  Economic perspective:
  - Minimise distortions of business decisions

  Legal perspective:
  - Fundamental freedoms
  - Parent-subsidiary Directive, Interest & Royalty Directive
- Reform options under consideration:

  Unilateral policy choices
  - Limit the scope of anti-avoidance provisions to abusive situations
  - Alternatives to traditional corporate income tax

  Multilateral reform options
  - Coordinating/ harmonising anti-avoidance provisions
  - Allow for source taxation of interest and royalties in case of thin capitalisation and earning stripping - amending the Interest & Royalty Directive
  - Anti-avoidance provisions within the scope of the proposed CCCTB Directive

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