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

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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 multinationals
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 intangible 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

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

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?

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; Zieke, Interetax 2010 (on TCR and comparable rules); Fontana, European Taxation 2006; KPMG 2008 (on CFC rules).
  – 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 intangible property
  – 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 (WTI 2009 & 2010)

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

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
• 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