

The 5th IMF–Japan High–Level Tax Conference for Asian Countries
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Principles of and lessons from regional harmonization

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What's the problem?

- ▶ NO harmonization may bring about
 - Transfer pricing and tax arbitrage
 - Harmful tax competition
 - Distortion of economic activities
 - Tax discrimination
 - Distortion of trade flows (e.g. export subsidies)
-- Cockfield(2012)

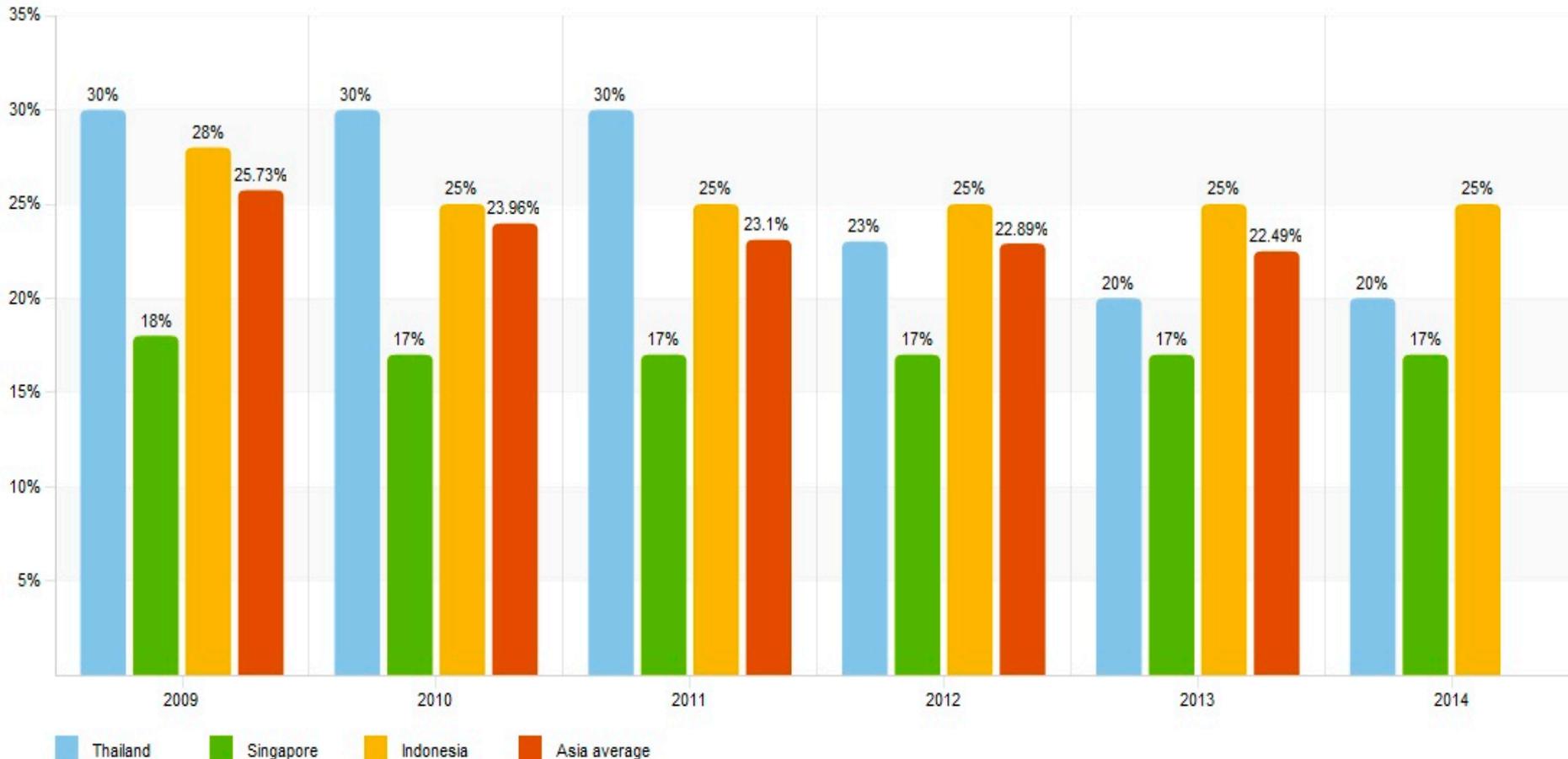
ASEAN Economic Community

- ▶ ASEAN Blueprint (2007)
 - Single Market and Production Base
 - (i) free flow of goods; (ii) free flow of services; (iii) free flow of investment; (iv) freer flow of capital; and (v) free flow of skilled labor.
 - Elimination of tariffs/non-tariff barriers
 - Taxation
 - Enhance of withholding structure
 - Network of bilateral agreements

Tax competition in south and east asia?



Corporate tax rates for 2009-2014



NAFTA

- ▶ Trade bloc
 - National Treatment: treating foreigners and locals equally.
 - Most-Favored-Nation (MFN) Treatment: providing equal trade advantages as the "most favored nation."
- ▶ How do they work?
 - Mainly applied to the treatment of indirect taxes on goods and services.

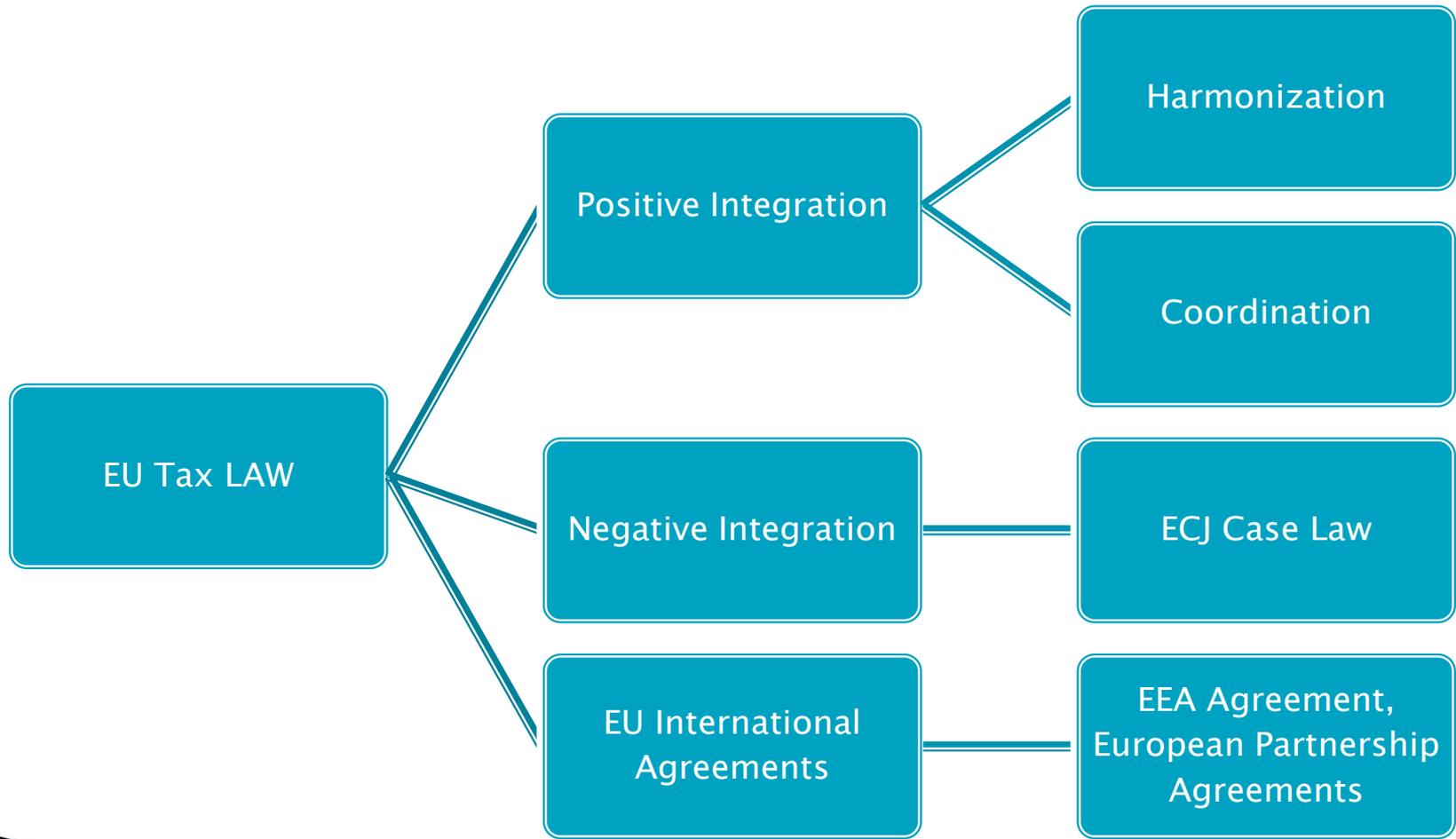
Income tax carve-out

- ▶ NOT generally applicable to direct tax (income tax) (Art. 2103(1))
 - National treatment shall apply to taxation measures on income...“that relate to the purchase or consumption of particular **services.**” (Art. 2103(4)(a))
- ▶ Primacy of (bilateral) tax treaties provisions (Art. 2103(2))
- ▶ Why?(Cockfield & Arnold(2010))
 - Critical government tool for domestic policies (Sovereignty)
 - No consensus view with optimal international tax policy
 - Little evidence for nondiscriminatory tax
 - Preferential income tax treatment to foreign investors

EC/EU treaty

- ▶ “The Community shall have as its task, by establishing a **common market** and an economic and monetary union and...”(Art. 2 of Treaty of Maastricht (1992))
- ▶ Removing obstacles
 - Limiting the Member States’ sovereign right in certain fields.
 - European Court of Justice (ECJ) directly applied freedom provisions of the Treaty (and Directives) to filed cases.
- ▶ Enhancing cooperation among tax authorities

EU (direct) tax law



See, Lang et al (2010)

Subsidiarity principle

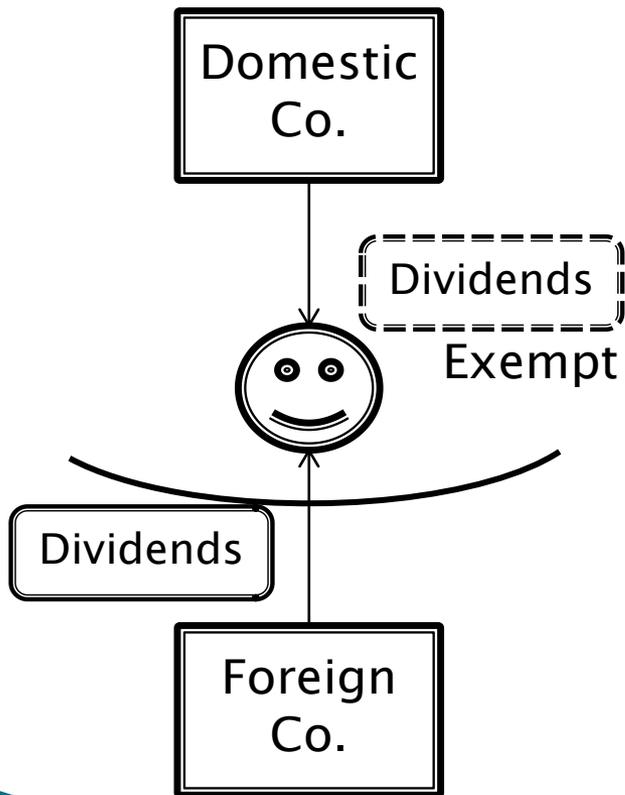
- ▶ “Under the principle of subsidiarity, in areas which do not fall within its exclusive competence, the Union shall act only if and insofar as the objectives of the proposed action cannot be sufficiently achieved by the Member States, either at central level or at regional and local level, but can rather, by reason of the scale or effects of the proposed action, be better achieved at Union level.”(Art. 5(3) of the Treaty on European Union)

Removing obstacles

- ▶ Directives
 - Parent–Subsidiary Directive
 - Merger Directive
 - Interest and Royalties Directive
- ▶ European Court of Justice case law
 - Fundamental Freedoms
 - Freedom of establishment
 - Free movement of workers
 - Free movement of capital etc.
 - Prohibition on State Aid
 - Directives

Free movement of capital

-- Verkooijen case (ECJ 6 June 2000, C-35/98)

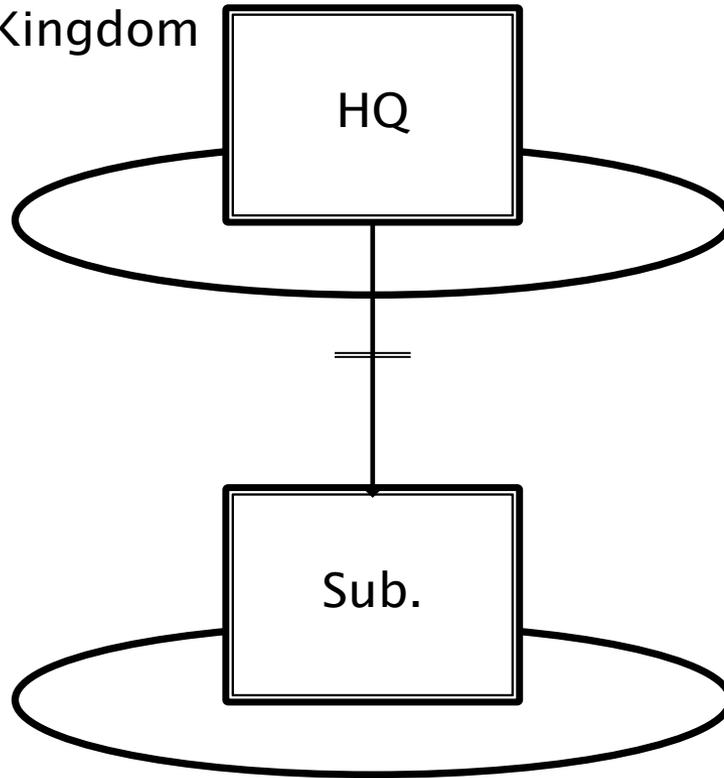


- ▶ Because it had “the effect of dissuading” Dutch investors from buying stock of companies in other Member States.
- ▶ There was no “direct link” between the corporate and shareholder taxes, which it described as “two separate taxes levied on different taxpayers.”

Freedom of establishment

-- Cadbury Schweppes case (ECJ
12 September 2006, C-196/04)

United Kingdom



Ireland

- ▶ UK CFC rules
- ▶ Discriminatory provisions targeting at anti-abuse may only be justified where targeting at **“wholly artificial arrangements.”**

Freedom of establishment

-- X holding case (ECJ 25 February 2010, C-337/08)

- ▶ Netherland group taxation system was limited to domestic companies.
- ▶ Acceptance of the possibility of including a non-resident subsidiary allows the parent company to “choose freely the Member State in which the losses of that subsidiary are to be taken into account.” So “justified in view of the need to safeguard the allocation of the power to impose taxes between the Member States.”

Enhancing cooperation among tax authorities

- ▶ Mutual Assistance Directive
- ▶ Recovery Assistance Directive
- ▶ VAT Information Exchange System
- ▶ Savings Directive

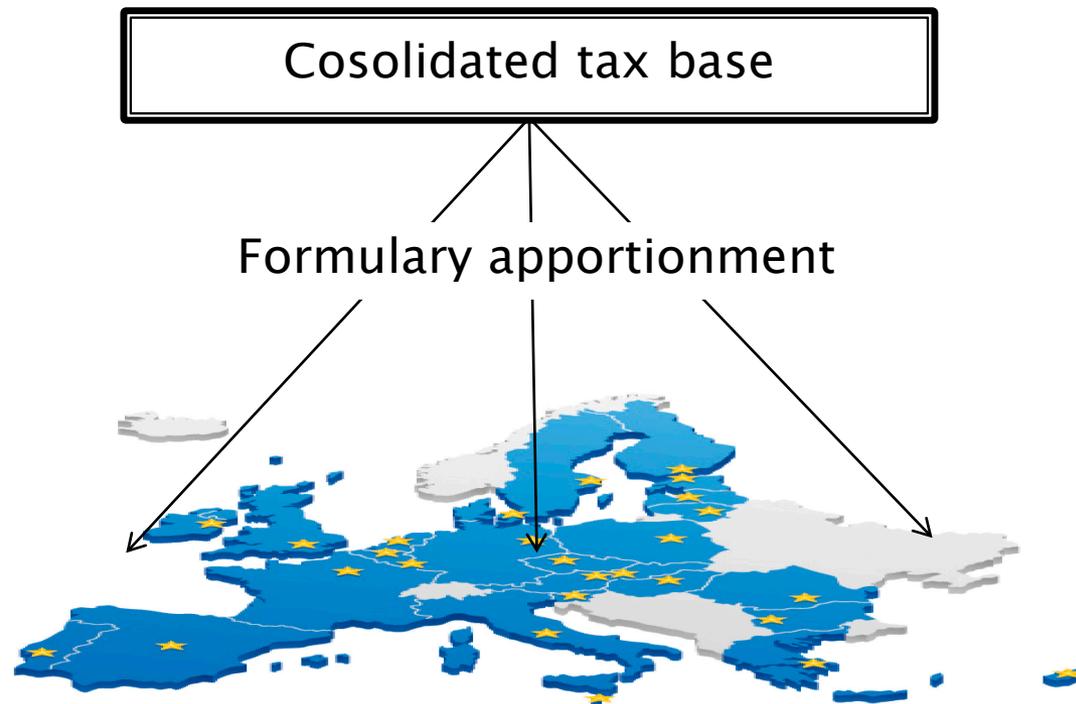
The fight against tax fraud and tax evasion

- ▶ Tax officials cannot recover taxes themselves outside their national borders.
 - Mutual Assistance Directive and Recovery Assistance Directive;
 - VAT information exchange system (VIES)
- ▶ Free movement of capital
 - Revision to Saving Directive (24 March 2014) strengthening EU rules on the exchange of information on savings incomes

Moving towards creating a single, unique EU-wide TIN

Harmonization of corporate tax?

- ▶ Harmonization of corporate tax
 - A proposal for a Council Directive on a Common Consolidated Corporate Tax Base: CCCTB (2011)



Anti harmful tax competition

- ▶ Code of Conduct (business taxation)
 - an effective level of taxation which is significantly lower than the general level of taxation in the country concerned;
 - tax benefits reserved for non-residents;
 - tax incentives for activities which are isolated from the domestic economy and therefore have no impact on the national tax base;
 - granting of tax advantages even in the absence of any real economic activity;
 - the basis of profit determination for companies in a multinational group departs from internationally accepted rules, in particular those approved by the OECD;
 - lack of transparency.
- ▶ Not legally binding, but monitoring and reporting.

Prohibition on state aid

- ▶ “...any aid granted by a Member State or through State resources **in any form** whatsoever which distorts or threatens to distort competition by favouring certain undertakings or the production of certain goods shall, in so far as it affects trade between Member States, be incompatible with the internal market.”(Art. 107(1) of TFEU)
→ Prohibiting “selective advantage” (selectivity test)
- ▶ European Commission is delegated to investigate and monitor MS’s state aid.

(UK) Patent box

- ▶ UK Patent Box offers a reduced 10% corporation tax rate (compared to standard 23% rate) for profits on UK or EU patents. (introduced on 1 April 2013)
- ▶ EU's Code of Conduct Group for Business Tax concluded that the UK Patent Box tax incentive is a harmful tax measure. (25 October 2013)
- ▶ →next stage is a discussion at ECOFIN.

Foundations of EU harmonization

- ▶ Concept of Single market / Common market
 - Free flow of goods, services, capital and labor
- ▶ Centralized harmonization
 - Centralized institutions (European Commission and ECJ)
 - Consensus to develop further integration
 - Gradualism – subsidiarity principle
- ▶ But...

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