European Commission
Taxation and Customs Union

Designing and Implementing a Destination-Based Corporate Tax

M. Devereux and R. de la Feria

Discussion by G. Nicodeme, DG TAXUD

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Views are those of the author and shall not be attributed to the European Commission

The Future of Tax Policy in the EU

- 2000 CEPS report (CEPS Tax Task Force)
- "The Future of Tax Policy in the EU: from 'Harmful' Tax Competition to EU Corporate Tax Reform
- (Malcolm Gammie, Claudio Radaelli)

- Influential for the works on CCCTB

Distortions in the current CIT

- 2011, EU27:
  - Adjusted top statutory tax rate on corporate income: 23.1%
  - CIT/GDP: 2.50%
  - ITR Corporate Income: between 17 and 27% (ITR Labour 35.8%)
  - Gross Operating Surplus Corporations: 21.5% GDP
  - Hence, CIT/GOS = about 11%

Fundamental Reform of CIT: Cash-Flow Taxation

- Meade Committee (IFS, 1978)

Could/should address issues/distortions:

- Debt vs Equity
- New equity vs retained earnings
- Organization form
- Domestic Investment
- Location of real investment (FDI)
- Location of tax base (Profit-shifting)

Fundamental Tax Reforms
Devereux and Sorensen 2006

Location of tax base	Type of income subject to business tax		
	Full return to equity	Full return to capital	Rent
Source country	1. Conventional corporate income tax with exemption of foreign source income	4. Dual income tax; 5. Comprehensive Business Income Tax	6. Corporation tax with an Allowance for Corporate Equity; 7. Source-based cash flow corporation tax
Residence country of corporate head office	2. Residence-based corporate income tax with a credit for foreign taxes		
Residence country of personal shareholders	3. Residence-based shareholder tax		
Destination country of final consumption			8. Full destination-based cash flow tax; 9. VAT-type destination-based cash flow tax

Design of Cash-Flow CIT (Devereux and Sorensen 2006)

Cash-flow CIT could potentially be

- Source-based cash-flow CIT:
  - domestic and foreign sales – domestic and foreign purchases – labour costs

- Full destination-based cash-flow CIT:
  - domestic sales – cash and labour expenses for production of domestic sales

- VAT-type destination-based CIT:
  - domestic sales – domestic purchases – labour cost
  - Export sales untaxed – imports taxed

- R-base or R+F base ?

Design of Cash-Flow CIT
(Devereux and Sorensen 2006)

Problems solved:

- All options:
  - falls on pure rents, domestic investment (EMTR=0), Deferral (timing not important), organizational choice, debt vs equity, new equity vs retained earnings

- Full destination-based cash-flow CIT:
  - No incentives to relocate

- VAT-type destination-based CIT:
  - Micmics VAT, no incentive to relocate

Design of Cash-Flow CIT (Devereux and Sorensen 2006)

Problems remaining

- All options: transitional issues, tax rate changes (timing investment)

- Source-based cash-flow CIT:
  - Profit shifting and location shifting (unless intragroup transactions included)

- Full destination-based cash-flow CIT:
  - Need to identify costs related to domestic sales
  - Taxes sales from abroad (current Int'l law: tax PE or Subs)

- VAT-type destination-based FAT
  - Difficulties in implementation due to impact on exchange rates

Experiences with Cash-Flow Taxes

- OECD (2007):
  - UK North Sea Fiscal Regime
  - Petroleum Tax in Norway
  - IRAP *Imposta Regionale sulle Attività Produttive* in Italy
  - Estonian Cash-flow tax
- *Impuesto Empresarial a Tasa Única* (IETU) in Mexico
- Recently, Hungarian cash-flow tax on SMEs