Champter 2

The Damages of Fiscal Competition in Europe and Alternatives to Anarchy[1]

Salvatore Biasco
University of Rome, La Sapienza

1. Introduction

Let us start with a summary. It is not generally understood that in the area of taxation important parts of the regulation of world capitalism are at stake. And the fact has escaped many that - still in the field of taxation - the only truly global rule for any length of time was introduced and signed by a host of countries in October 2014 regarding the automatic exchange of information among fiscal authorities. Whilst this represents a revolutionary development (as we will see later) given that it presents some serious problems to holders of a great amount of wealth, to tax evaders and to money launderers - it is nevertheless incomplete. It does not present, in fact, any particular problem for multinationals to *legally* avoid paying taxes, and subtract them from the country where the income is generated, basically keeping them for themselves. This not only causes a loss of revenue but also distorts competition in their favor. We must tackle a situation where companies such as Amazon, Apple, and Starbucks and many others, are approximately taxed at 2% on their profits while other producers are subjected to full taxation and labour is overtaxed. Enormous losses of revenue (from tax avoidance, evasion and illegal activities) are at stake, to the tune of as much as 1,000 billion euros annually according to the previous Commission's own estimates[2].

The argument goes that the nation-state is becoming less effective thanks to the extent of financial globalization. But in this field this is true only in part. The nation-states (especially the European ones) have not lost the power of taxation due to globalization but because of tax competition. In fiscal matters, the distortion of European construction is the weak link. And it is from Europe-- another Europe-- that could initiate a turnaround if the Union acts as a catalyst for countries to impose - by strength of their number and the voice of reason (and with the same political will that led to the agreement on information sharing) - a world-wide standard in taxation of multinational corporation. The frontier to be

[1] This essay is based on the Lecture given at the "European Interparliamentary Conference Under Article 13 of the Fiscal Compact" (29-30 September 2014), organized during the European Semester of Italian Presidency by the Italian Chamber of Deputies, Palazzo Montecitorio, in the Section: "The coordination of fiscal policies in Europe." Compared to that text, this has been extensively remodeled to be made less technical and accessible to the non-specialist reader. The author is Professor of International Monetary Economics and has been President of the Bicameral Commission for Tax Reform in the XIII Legislature (1996-2001) and author of the White Paper on CorporateTaxation (2007), drawn up by the Commission that bears his name.

[2] Recently, also Algirdas Semeta, Commissioner for Taxation and Customs Union, referred to the same number. As a reminder, the Union's budget is approximately150 billion euros.

crossed are represented by a system of unitary taxation of multinational corporations (that is, a taxation not fragmented, as it is now under the international conventions). This requires the creation of a consolidated taxation system on a global basis, apportioned according to an index of actual transactions in the individual countries. In Europe, such a transition could be an opportunity to combine the achievement of tax harmonization in the field of direct taxation with an enlargement of the EU budget, as well as with procedures to compensate those weaker countries that will lose the benefits they have reaped previously from tax competition. Let us now explore these issues in a more thorough way.

2. What is missing is a European model

While it goes without saying that the European level is the appropriate one to pursue a program for a U-turn in macroeconomic management, institutional architecture and, of course, financial regulation, it is not equally obvious that the same is true in the field of direct taxation. The latter resides now in a political sphere that is the autonomous responsibility of individual countries as if internal tax systems were not shaped in various ways by continental (and global) interactions.

In the field of direct taxation, Europe today is pervaded by a tax competition that has found and finds legitimacy in a neo-liberal vision of how the Union should operate. This vision has ruled out any idea that the Union could take upon itself the management of fiscal matters, and placed competition among States first, notwithstanding it led to a significant losses in fiscal revenue from the income generated by the more mobile factors which had then to be compensated by the taxation of those less mobile (labor and property). The point is not just to remove regimes that are particularistic and "harmful" – related to State aids aimed to foreign investors only (a goal pursued in an uncomplete way, however) - but to create a uniform and coherent tax structure for Europe. In this period of a weak European commitment by the leaders, and of a decidedly weakening momentum in public opinion (to say the least), such a proposal may seem radical, but it is an issue that must be put on the table. The ultimate aim should be to recover revenue lost through tax competition, compensating the weaker countries that had benefited from intra-Union competition, as well as starting a concrete process of substantially reducing the taxation of labor (which would otherwise remain an unfeasible admonishment in official documents). Finally, it should also lead to the identification of sources of revenue that could significantly increase the Community’s budget. And it is no small matter in this context if Europe would be placing itself in the vanguard of the proposal to overcome what are today the outdated assumptions that govern international agreements on transnational taxation and define a global standard for taxation that responds to the new realities of integrated capitalism.

Today, not only is there no European model for direct taxation, but there are not even mutually conforming codes on taxation and regulation. In the area of direct taxation the convergence towards common solutions for national systems takes place only through the imitation of schemes introduced in other European countries that individual countries choose in discretionary bricolage. The variety of solutions makes it difficult to refer to any single benchmark system.

Even in terms of principles there is no uniformity if we consider that the principle of progressivity in personal taxation is disregarded by many countries, especially in Eastern Europe where a *flat tax* is adopted (only slightly adjusted by allowing differentiated deductions). This suggests that the European social model is becoming an abstraction which applies to a limited number of member States.

3. Convergence is not always positive

We must not assume, however, that convergence in tax systems is always a good thing and can ensure a more efficient functioning of the internal market, nor that it leads to a more equitable taxation system. It is not positive when convergence is not an organized design with specific objectives or an overall rationale, but simply the outcome of a fiscal chase made for fear of losing taxable bases. It cannot even be said that the generalization of any particular scheme leads to a stop of the race to the bottom in its specific field of impact (whatever this concerns: regulation, fiscal treatment of the holdings, tax rates, e-commerce, tax bases, controls, etc.) because that race is always resumed with a + 1.. A good example is the taxation of the holding companies. The system that benefited them for the fiscal treatement of profits and capital gain, called Participation Exemption (Pex), was gradually extended from the Benelux countries to almost all other European countries at the beginning of 2000 to prevent the relocation of their holding companies. It would have been necessary for a European initiative to have been undertaken to prevent such a change and for the pre-existing tax system (of tax credit on dividends) to have been made systemic and truly European. But that never happened, and countries were left to decide on their own on what to do. However the spreading of the Pex system has not put an end to tax competition because the latter has been transferred to the domain of regulatory provisions in the legislation of some countries (e.g., the UK and the Netherlands). These countries facilitate opportunistic behavior by enabling companies established there to have effective management and the tax residence in a another country and, at the same time by allowing them to lock down the ownership by adopting a sheme of increased voting rights for stable shareholders (see, for example, the case of the transfer of the Fiat headquarters to Holland and the fiscal office to the UK),. As a result, a greater recognition of incresed voting rights of the major shareholder has spread to other European fiscal systems. It is inevitable that in the same way the regime of “patent box” will become more diffuse as part of the ongoing competition to attract the headquarters of multinational corporations. It allows for the imposition of an ad hoc tax (between 5% and 10%) on profits related to the use of patents. It is also called the "innovation box" because of its apparent purpose of encouraging innovation and skilled jobs in Research and Development, while in reality it rewards the commercialization of existing patents rather than the development of new ones. Given that with competion there is no end, there are countries (like Great Britain) where 100% of the profits earned on products that fall into this regime are recognized as valid even when the holding of the patents is secondary to their production .

Many of examples responding to this pattern have been endorsed by European Court of Justice in the name of a mistaken fundamentalism with which it interprets the "freedom of establishment" (beginning with the unhappy sentence for the Cadbury Schweppes case[3]). The Court has never been

[3] The Cadbury–Schweppes sentence was issued in connection with an appeal by the parent company settled in Britain against the national tax authorities. The case concerned the profits of two subsidiaries established in Ireland to qualify there for the lower rate of profits taxation. The lawsuit was filed (in 2000) against the British tax authorities which, according to the law in force in that country, obliged the parent company to compensate for the difference between

particularly attentive to the systemic consequences of its decisions but highly sensitive to the liberal bent of European integration.

4. We need a "grand design ": can we find it in recent developments?

What we need is a large-scale plan for the convergence and harmonization in fiscal matter and not occasional developments, competition, or judgements by the Court. Even those who think that the Court has performed its institutional task in compliance with the Treaties (with excess of zeal, in my opinion), agree that the Court action is not nor can it be the appropriate instrument for the resolution of the contradictions that dominate the present state of affairs. Furthermore, the Court certainly cannot replace the necessary political debate between the social forces and between the nation states whose role it is to make the essential decisions within the appropriate institution.

We need to ask ourselves the question of whether the three major advances in recent years respond to a far-reaching vision of the future working of the Union and are "grand designs. These are: the elimination of "harmful" competition, the countering of the use of tax havens and the intended launching of the CCTB **(***Common Consolidated Tax Base*, the basic design of a common consolidated base for corporations taxation).

5. A) "Harmful" and "non-harmful" tax competition

It is only since the mid-nineties that it has become clear that the actions set out by the OECD to address the issue of tax havens would not have been credible if the EU Member States had not been seriously committed to removing the "particularistic" and preferential regimes for foreign capital provided on their territory and benefiting large companies and non-resident wealthy individuals.[4] Those tax regimes have been identified as constituting "harmful" competition, which thus have been distinguished in a subjective manner from "non-harmful" competition. How to define the latter, "fair", "virtuous" or "beneficial" in nature?

It is all well and good that those regimes are being removed. But this does not mean that there are not still niches protected from the law and dark corners of which companies can benefit in one country or in another as, for example, in the field of patents and licenses (as we will see later). Formal discriminatory allowances do not exhaust the picture. There persists favorable treatment of

---

taxes paid abroad and taxes that should have been paid in the United Kingdom if the company had been resident in that country. The sentence (in September 2006) was in favour of Cadbury on the principle enshrined in the treaties of "freedom of establishment", which from then on has become the principle that deprived individual national authorities of the power to limit tax competition.

[4] "Particularistic" was the definition used due to the fact that residents did not have the possibility of accessing the same regime.

those who move from abroad and benefit from weaker controls than in their countries of origin. Even the definition of taxable income plays a role in attracting foreign capital. And the actions of the Court have affirmed the dubious notion that any tax initiative by the nation state is acceptable if it does not discriminate between foreign and domestic operators.

It should have attracted attention that, within the limits of the success of the ban on "harmful competition", policies directed to a general reduction of tax rates and to the narrowing of the tax base tended (and tends) to be the dominant mode of tax competition - specially in the new member countries spurred by the example of Ireland[5]. The abatement of tax rates on profits will certainly be non-discriminatory, but, as most of the economics literature tells us, it can also distort the allocation of capital and production, resulting in a negative spillover effect on those countries that are affected. Maybe we should be asking ourselves if there is such a thing as virtuous or fair or beneficial tax competition. The arguments in favor of competition are well known, but they are overwhelmed by the evidence that "beneficial" competition tends to distort the structure of personal taxation[6], or to bring about a loss of overall taxable income to be offset by taxes on non-mobile factors or by a reduction in public spending. It also provides incentives for profit shifting resulting in an inefficient level of public goods, and it tends to lead to business decisions that distort the single market as it brings capital to where it is taxed less and not necessarily where it is used more productively.

Therefore, it would not constitute a "grand design" to remove the unfair competition even if it does represent a significant advancement. It would represent a grand design[7] if:

● the harmonization of the rate of corporate tax was still listed as a legitimate medium-term objective of the European Union. As an intermediate step, it would be appropriate to keep differences in corporate tax within a predetermined range (but with a common tax base). Although the advantages of agglomeration can allow larger countries to maintain competitiveness with a higher than average rate, this is true to a certain extent only and does not justify anyhow that a minimum tax rate on corporation (at least 25%) is not fixed in order to curb the continuous exodus of companies from one country to another in the pursuit of more favorable taxation; an exodus which is often obtained with real promotion campaigns (that are not considered to be "unfair").

---

[5] Ireland rate on profits is fixed at 12.5%. The average tax rate on profits in Europe has being decreasing from 45% in 1980 to 24% in 2014, with an ever narrowing variance. The trend is contininuing.

[6] It impinges upon progressivity in personal taxation, because a high marginal rate on personal income tax make convenient for rich people to tranform personal incomes ino capital incomes.

[7] A graphic notation: the bullet points indicate lines of action and possible contents that are desirable for the Union to pursue.

● furthermore, if the EU moved towards the establishment of uniform controls aimed at checking on the gains and losses of taxation that generate differences on production and labor taxes.

The weaker countries would be helped to compete on the basis of real economic factors and not by offering facilities designed to infringe the laws of others; for this, and other reasons, a more consistent European budget is needed (as discussed later)

6. B) Countering the tax havens

Is it part of a grand design the actions taken by the EU to counter tax havens in the wake of the OECD model of cooperation? Undoubtedly, the fact that we have arrived to outline the problem in the three features according to which it is articulated represents a clear step forward; These are: 1) the lack of transparency and exchange of information, namely the 'service of secrecy' that is offered by tax havens, 2) the lack of substantial activity associated with the location of a company in a tax haven, 3) the low or no taxation on foreign incomes (that may be differentiated or not vis-a-vis local residents).

So far rule enforcement has focused almost exclusively on the first problem on the basis of the OECD project that is being implemented at the European level. Despite this limitation, we should be rejoicing that the system is moving from an approach where financial information is provided on a targeted request basis to a model where information is obtained automatically with a direct access to the financial data of another country (starting from September 2017). For sure, information provided through the previous international regime did not prove to be particularly effective in curbing harmful competition from tax havens if we consider that the amount of funds held offshore has increased dramatically during the past decade. The fact that 58 countries signed on 30 October 2014 in Berlin the agreement for the automatic exchange of information held in their financial system is highly significant. As already stated, it is perhaps the only global rule that has been adopted by a large group of countries for decades; a rule that promises to create a new world order in taxation if it is applied in all financial centers. What sufficed was the sheer determination of the US and other major countries to arrive at this outcome for reasons of security (after 9/11) and to stop tax evasion, This has made it impossible for a country that wants to be respected in the international community to avoid joining the agreement with others. Even Luxembourg and other European countries that were considered to be tax havens - as well as the Cayman Islands, Singapore, San Marino, and others - have agreed to comply. The pressure to join is clear if the agreement was signed even by Liechtenstein and Montecarlo, while other countries have announced that they will do the same. It is a leap in quality in countering illegal capital movements and tax evasion[8].

All good, but it is necessary to maintain a vigilant attitude in order for the commitments made by the countries to be actually put into place and for these countries to express a real ability and will to oblige local operators to collect and systematically transmit data to be exchanged according to the agreed standard of protocols and models referred to as the *Common Report and Due Diligence Standard*. And there must be a system of effective sanctions for those countries that do not comply. Moreover, the banking license for those financial institutions that do not cooperate, boycott or prove particularly active in promoting tax avoidance should be withdrawn. Moreover, the difficulty and delays in applying the new standard in all of the financial centers must not be seen as an opportunity for some subscriber (within or outside of the EU) to delay implementation of the system.

- It should not be difficult (by simplifying technical requirements) to obtain an international *tax payer identification number*, first at the European level and then at the global level. In the field of security it was sufficient the political will to create at a global level a system which gives access to Interpol records from each part of the world simply with a passport identification number; the same should and could be done in the field of taxation if there were the political will. It is important for the EU and the OECD to standardize the rules, but it would be even better if the process were led by an UN agency. Notwithstanding the fact that Europe entrusts the study of the issue to the OECD, this institution does not have the legitimacy or territorial representation to make it global. It is not an intergovernmental organization, but a research center for a number of advanced countries (including those inclined to act as dubious financial magnets).

7. C) The ineffectiveness in countering the use of tax havens for fictitious activities

On what regards transparency and the exchange of information, the system is certainly changing features in the right direction that makes it coordinated and integrated in the aim to weaken the role of tax havens in financial flows. However, on what regards tax avoidance through fictitious activities located in low-tax areas, the conteracting steps still lie withindividual countries. Practices associated with tax avoidance will not disappear even with a fully automatic system for the exchange of information. At the heart of the problem are the artificial constructs creating activities of convenience in

[8] To appreciate the event lets us remember that it took eleven years from when the European directive on savings of 2003 was launched to close loopholes and extend the scope of application to a sufficient range of financial instruments. That directive aimed at making financial income realized elsewhere subject to taxation in the country of residence (with exception of Luxembourg, Austria and Ireland) but its correction was long retarded due to the presence in Europe of countries that took advantage of such loopholes.

the tax havens and using them for advantageous triangulations. To counter such imaginative schemes, countries apply a set of defensive actions under the guidelines of so-called CFC approach (*Controlled Foreign Companies*).

The reclassification of budgets by fiscal administrations under this approach remains, however, an inefficient and cumbersome process, aiming at attributing to the national company all or part of the profits generated by the foreign subsidiary located in low-tax countries. The European context reveals the heterogeneity of each of the essential characteristics that condition the application of CFC rules: from restrictions on the deduction of taxes paid elsewhere, to the failure to recognize specific costs, to the introduction of withholding taxes on payments made to black listed countries, to the presumptions of internal residence of the company settled abroad, to rules on transfer prices, to a restrictive interpretation of notions of control and connection between firms, and to the monitoring of derivatives and financial mechanisms that contribute to *profit shifting*, etc.[9]. In whatever way it is applied, the CFC approach is not systematic; it implies subjective judgments and moreover, creates administrative problems, uncertainties and difficulties in the compliance with or in the provision of contrasting evidence. In this way it contributes to a non monetary fiscal competition, by making attractive, in a kind of vicious circle, those (advanced) countries that allow companies the undisturbed use of tax loopholes. Not surprisingly sentences of the European Court of Justice have diminished the effectiveness of protective measures adopted by individual countries affected by this competition by imposing a disapplication of such measures or their mitigation for fear that applying them within the EU will impact on the freedom of establishment within the Single Market.

8. Google, Apple, and so on...

Defensive actions are pointless when the emptying of the profits generated in Europe by multinational corporations located in the Continent are *legally* transferred to branches settled in areas with low or no taxation. This happens with the involvement of European countries that acknowledge, or allow, or agree with multinationals the use of specific practices. These countries aim at externalities that the establishment of multinational operational headquarters on their territory generates (in terms of well paid and qualified jobs, of the use on site of financial services, or of other economic fall-outs), rather than at potential tax revenues, which are allowed to vanish. Recently, attention has been focused on cases of multinational companies such as Apple, Amazon, Starbucks, HP, Google[10]. These companies

[9] However we must note that since 2012 the UK has abandoned the presumption of tax avoidance for the activity of an enterprise located in a tax haven

[10] But also Ikea, PepsiCo. FedEx, Procter & Gamble, Vodafone, Microsoft, etc. etc.

represent only the tip of an iceberg in a widespread phenomenon. As a result, the EU has opened an investigation in which Luxembourg is refusing to adequately cooperate by refusing to reveal details of its tax system.

The mechanism of *tax avoidance* is fairly uniform. Multinationals use the prices of internal transactions to attribute a low profit margin to activities in countries with high taxation and where they have a significant share of the market. Potentially they direct profits to the country where their parent unit is established, but from this base they make deductible payments to subsidiaries that have been created on an ad hoc basis outside of the EU, in tax havens (with low or zero taxation) for the purpose of "providing" loans, or the use of the trademark, patents or other services. Sometimes these subsidiaries simply have a legal right (*economic ownership*) to a sort of usufruct on income of the parent company (which maintains the *legal ownership*). Needless to say, the headquarters are in countries such as Luxembourg, the Netherlands, Ireland and in part, Belgium, where the taxation is low at the outset (sometimes agreed in advance[11]), and where there is no withholding tax on payments for non-material services abroad[12], nor the practice of (fictitiously) dislocating branches is called into question. Neither it is compulsory in some of them to give evidence of a subsidary's budget if the operating unit (i.e. where strategic decisions are taken) is located abroad and the subsidiary is 100% owned and unincorporated. It would be interesting to follow the many imaginative cases of corporate fiscal practices. To cite just a few concrete examples, it may happen that the profits before tax declared by the European parent company of Starbucks located in the Netherlands have generated only 342,000 euro of taxes in 2013 (the year reported loss, as in 2012 and 2011) on European sales of 92.5 million euro (over 55% of which goes to cover costs for rights to the trademark "paid" to subsidiaries based in tax havens)[13]. Amazon, located in Luxembourg, adopts the same practices, but this time the payments for intangible services are paid to a subsidiary in Luxembourg, which is virtually free of taxes (taxable profits: 3 cents per 1,000 euro of turnover).[14] Incidentally, it is estimated that Luxembourg is the home of 40,000 holding

[11] Agreements are made through the so-called tax ruling or APA (*transaction tax agreement*) when companies ask in advance what their taxation will be upon their relocation. "Normal" taxation rates are then applied (which do not result in "harmful competition", 25% in the Netherlands for example), but the abatement of the tax base or other provisions reduce dramatically the taxable profits.

[12] Such a tax exists in Italy, for example, although it is only 5% for countries that have subcibed to a convention and is 30% for the others. In each of the tax havens within the Union there are no withholding taxes on payments for intangibles.

[13] A British survey highlights that since its arrival in Britain in 1988, Starbucks' paid until 2012 cumulatively taxes for 11.5 ml euro against sales of 4.5 billion euro.

[14] Ordering a book worth 50 euro, for instance, generates an integrated taxable profit of 1.5 cents. Amazon has eight mega warehouses in Great Britain and 6,000 employees; It has a large number of employees in France, and Germany, but the bulk of the profits go to its Luxembourg headquarter where it has 200 employees.

companies. Google uses a triangulation of Ireland - Netherlands - Bermuda (2 cents of taxable income per 1,000 euro of sales). Even more striking is the case of Apple; not so much because out of almost 20 billion profits it pays more or less 8 million (less than 1 per cent) euros in global taxes (the average of the three budgets 2011-3), but because it channeled the actual profits in deductible payments to three subsidiaries of its Irish head office that do not have a physical residence declared anywhere in the world, one of which has never published its financial statements (which is legal according to Irish law)[15].

Observing the situation from the point of view of the firms that compete with the ones mentioned (or in similar cases) we can see to what extent tax avoidance distorts competition in the market (as well as being detrimental to the finances of those countries which are deprived of the tax revenue of their competence), in that it gives companies that are virtually tax-free the possibility of cannibalizing competitors unless the latter are able to imitate them and follow them in this dangerous game.[16]

9. .... and the digital economy. Two possible solutions.

Similar constructs can exist in the entire digital economy[17], when companies that sell services on line can have access to Internet from any location. Sometimes these services do not result in the delivery of a physical object (e.g., music, software, etc.). It is even difficult to pinpoint exactly where profits are diverted, because it is difficult to identify where the server – considered to be the company headquarters - is located. It may, to the limit, be on some platform outside of territorial waters. But even in standard cases, companies in the digital economy may not require a fixed presence in the country where they sell

---

[15] This was raised in the US Senate's inquiry into Apple. Explaining which legal loopholes make it possible implies to going into techical details. In a nutshell, companies in Ireland are considered foreign companies if ther effective management is abroad. At the same time, they are also considered foreign companies for the fiscal administration of the US if they are legally established outside national borders. Moreover, in Ireland they are not obliged to publish their financial statement if they are unincorporated (as Apple's subsidiaries are). In major European markets, Apple fixes (from Ireland) wholesale prices to subsidiaries in order to limit the profits taxed locally. In 2011, for example, Apple declared local losses of the local holding company in Germany and France and paid taxes for 10.5 million euros in the UK on sales of more than 1.3 billion euros.

[16] This paper was already written (the report to the European Parliaments is dated 30 September 2014) when, a month later, the Junker case broke (Prime Minister of Luxemburg for 15 years) on the secret agreements signed by his country with many multinational companies to obtain settlement in exchange for the remission of taxes. So far, only agreements brokered by the consulting firm Pricewaterhouse Coopers have emerged. If I was fully aware of the existence of such practices how was it possible that they were not known to oher political leaders in Europe? Perhaps they have not stopped this practice because tax competition is beneficial? Moreover, how could it have escaped the European Parliament's notice that Junker had been for decades Luxembourg Prime Minister?

[17] The digital economy represents 5% of GDP in Western countries and is rapidly growing. It is plausible to assume it will reach double-digit levels soon.

and are therefore not subject to taxation on site. Among other things, the power to *enforce* payments to the tax authorities where the sales take place vanishes as is evident with the application of VAT.

There are two possible solutions to make activities and incomes subjected to taxation that would otherwise be avoided: one is based on a greater reach and can be more easily implemented; the other is an organic and potentially global solution, but it would require the same kind of *political determination* that led to the agreement on information being provided automatically.

10. C_1) The digital tax and the belated reactions of governments

● Within the first approach, the way out is to switch to a principle of taxation at source, *at least for the trade on line* of intangibles, *by* applying a flat withholding tax on the value of sales and assuming that income has been generated where there are logistics centers or where the company has significant market share, or where substantial economic activity takes place, and the value is created. In fact (even if not in law), it would be nothing more than a duplicate of VAT (that, considered as a direct tax, must not be allowed to fall on the consumer). This is a way of buffering the possibility that transfer prices or the absence of a stale organization evaporates the tax base in the country where the income is produced (and sometimes even where the company has its place of residence). At the opposite end, the risks of double taxation have to be ignored.

In essence, we are talking about a rethink of the international system of distribution of taxable income based on bilateral treaties to prevent double taxation. Called the principle of *Home State Taxation*, it is a principle that taxes revenue at the source, and recognizes the amount already paid in taxes elsewhere whilst going through the pyramid chain of ownership towards the country where the headquarters of the company resides[18]. This principle assumes a physical presence and a stable organization in each foreign territory. This solution worked well when the digital economy did not exist, as there was little opportunity to shift profits via internal transfer pricing, as was the ability to route service activities through tax havens or to do without a permanent organization, but these days this is obsolete.

[18] The first tranche of taxation goes to the state where the company operates with a a stable organization (in practice, the local head company in the area). The state in which the parent company operates upstream applies the second tranche according to itsr own criteria, and so on, recognizing what has already been paid in income taxes in those countries with which it has signed a treaty against double taxation Today, the principle of *Home State Taxation* is undermined not only by the management of transfer pricing in internal trade of conglomerates, but also by the fact that in the digital economy a stable organization in the country of sales is not necessary. However, the new EU rules on *indirect* taxes, VAT, (which came into force in 2015) states that companies that sell online certain services (and with sales amounts exceeding certain thresholds) should identify themselves in every EU consumer country.

Taxing at source on the basis of sales (and not income) is a defensive solution with many risks, but it is linear and able to provide some cover to a situation that is quickly getting out of hand. However, it is not easy to erect a barrier between the digital economy and a not digital one, and above all, to do it purely for tax reasons. Moreover, it does not solve cases like Starbucks or Pepsi Cola, which do not sell anything online.

It may not be said that governments today are not taking remedial measures after being late in realizing what has been happening. The UE (and OECD) have long instituted study committees for the launching of a digital tax along the lines referred above as a buffer solution. However a European directive for giving rise to a single market in this field is all but imminent, and thus, having waited for it for years, many European countries have announced possible interventions but abstain from approving their own solutions[19].

Anyhow these countries have now realized that they have been deprived of a great deal of tax recevenues which have been diverted abroad through the practices of multinational enterprises. They therefore have taken steps to retrieve these receipts. Whenever there are sufficient elements (managers, employee, offices operating in the country as well as e-mail contents) they act on the presumption (to be proven) that the multinational enterprises in question have operated in the country with a shadow stable organization. In other words, they sustain that operations were conducted not from abroad but by intermediary organizations operating in the country and unknown to the fiscal authorities whose profits generated on site would have been subject to ordinary taxation if this organization had been registered. In the cases in which such revenue is actually retrieved this is a result of complex negotiations with companies, which always claim to have acted in the respect of the rules. Today multinationals understand that damages to their reputation coming from these contentions are worse than losing some profits, and hence are forced to come to a compromise (that closes invariably far from the pretention of governments). Currently, Italy and U.K. are leading the way[20]. However, it is a path where each country acts individually and which for now is limited to emblematic cases. This does not mean that such actions do not have discouraging effects.

---

[19] The solution foreshadowed for Italy provides a whitholding tax of 25% on on-line sale, unless the seller establishes in the country a stabe organization. In this case it would be taxed on an ordinary basis.

[20] Italy has agreed with Apple a payment of 318 ml euros out of a pretention of 979 mln for profits generetad in the country in the years 2008-14. As a part of the agreement, Apple will establish a stable organization. The strong weapon to convince this company to close the litigation was the threat of a criminal investigation. At present, other cases are open with Google, Amazon, Twitter and a few other giants. In Grea Britain, the case against Google has been closed with the payment of a modest sum of 130 mln pounds covering the period 2005-15. Great Britain has approved a levy of 25% on sales as a tax on (imputed) profits obtained by multinationals whithin the national bounderies (and appliable to those operating without stable organization and throug offshore branches). It is called the Diverted Profit Tax. See Chapter 7 for more details.

Even the EU has taken notice after the outcry raised in the press on the issue of tax avoidance. Its strategy is to verify whether preliminary agreements that a few countries have undertaken with multinationals (agreement, however, that other countries are gradually introducing in their tax ruling, as Italy for example) presuppose preferential taxation, and hence state aids. The road is a long and contested one and for now has produced the very small mouse inobliging some firms to return irrelevant sums of money to those countries responsible for allowing tax avoidance (Luxemburg and Netherland in the case), With the paradoxical result that the fiscal incentives have already attracted companies whilst the host country has become capable of using that same revenue which it had given up in order to achieve that objective[21].

Also deterrence through transparency is a line that has recently been followed. This line provide for automatic information on tax rulings that companies enjoy in the European context, as well as on their profits and turnover in any single country in order to put member countries in the condition to verify the coherence of firms fiscal statements[22].

From any perspective, all this entails disorganic and complicated solutions which, at best, may work as a weak obstacle and lead to some refrain in the use of questionable practices and rules (as we can already see from the changes introduced in the Irish legislation[23]). However, these are neither systematic not collective solutions while a solution with these features could exist and could become the international standard on corporate taxation.

11. C_2) The organic and wide-ranging solution

● The "grand design" in this field, would ideally be one which jointly resolves all the problems we have discussed: it would be a design that aims to move towards a *unitary taxation of transnational corporations*. Unitary taxation means taxation on a company's integrated global income. This principle

---

[21] At the moment, only investigations on Fiat (Luxemburg) and Starbucks (Netherland) have been ended and the host countries "condemned" to retrieve almost 30 mln euros in each case. The last investigation which has been opened is on MacDonald.

[22] It has to be singled out that, whithin the BERS project (Base Erosion and Profit Shifting), Europe has expressed an intention to limit the fiscal recognition for interests payed by a foreign branch to its parent company. This would check the convenience for ad hoc budget adjustments aimed at shifting taxable income from a hig tax country toward a low tax one. Yet, the intention of introducing a kind of exit tax for productive activities or asset transferred abroad for fiscal reasons belongs to the same objective of curbing special practises. It might be asked whether this chasing of each of the devices that firms use for fiscal planning is better than having a fiscal harmonization of tax rates on profits. See the following chapter by Russo on the BERS project.

[23] Under international pressure, Ireland has proposed to approve a legislation that set at 6.25 (half of the ordinary rate of 12.5%) the profit tax rate charged under its patent box scheme, which would now be appliable only to intellectual products coming from research carried out in the country. So far a great deal of research had been carried out abroad, as in the case of Google.

allows for the achievement of an effective and organic overcoming of the previous international taxation standard whose contents were designed 100 years ago when today's reality of multinational corporations did not exist nor was there the free movements of capital. Such corporations are not made up of a series of local units to be taxed separately at different sites in the same way as if they were independent units, as the current convention against double taxation tends to see them. Instead, they form all together a strictly connected business unit that derives its competitive capabilities by combining economic activities in individual locations as well as by exploiting technology and knowledge belonging to that unit. If they are a single body of which each branch is an organic part then as a single body they must be treated. Hence reference for taxing them should be to their *worldwide consolidated* budget. Multinationals should submit it in every country where they operate, and then their integrated profits should be taxed in a unitary way according to agreed formulas for apportionment of income that reflects the actual presence in each country. The formula must weigh the distribution of a) physical units (or costs) of the workforce employed, b) physical assets used (excluding intangible assets) and c) sales realized in each country. The economic literature has discussed this point. Finding agreed unitary accounting criteria to compile financial statements is a relative simple problem to overcome given the current existence of accepted accounting standards,

A scheme of this kind, which eliminates internal transactions, would eradicate the economic convenience of making fictitious constructs in tax havens or moving profits around the globe through internal trade pricing. When the conglomerate is taken as a unitary center the final result makes irrelevant the location of subsidiaries or the transfer of prices. Companies themselves would benefit from the scheme since it allows them to offset profits and losses obtained in different countries and to reduce the cost of compliance. Fiscal authorities would benefit as well as they would not have to reformulate company accounts and implement complex defensive measures along the CFC’s line of approach from which many disputes have arisen which often involve other administrations and require complicated and never ending mediations. This new system needs to be brought about in the name of a just and ethical tax system as well as the regulation of world capitalism that is in line with today’s reality.

The regime of a unitary taxation regime has also the advantage of being able to be applied by a group of countries even before an international agreement makes it the new standard in taxation. But it would still be appropriate that it be extended on a global level. Europe should lead the way in applying the regime globally taking advantage of the support that it enjoys in Canada and the US, where it is included in the provisions of the Dodd-Frank act, and where many federal States are already adopting it to protect themselves from tax competition from within the States.

12. The European CCTB (corporate tax on a common consolidated base)

Can we conclude that the Common Consolidated Tax Base, passed by the European Parliament is a grand design"? It could be, but it stops at the door. In its current form, it is significantly limited in scope.

● 1) The CCTB should be mandatory, whereas the current project makes it optional, meaning that two parallel systems would co-exist and companies could choose between them, forcing the national authorities to deal with both. It would end up being the 29th EU tax system, not a distinct and truly European system of company taxation (a system that at best the European Union itself could administer retaining a portion of its proceeds for its budget).

● 2) It should provide a harmonization of taxes on profits, because otherwise it would still keep alive a tax competition aimed at capturing the location of firms and continues a race to the bottom. In place of such an outcome it is preferable that: the harmonization of tax rates be combined with an additional criterion among those foreshadowed to apportion the consolidated profits of multinationals (so far: labor, physical assets and sales); a criterion, whose rationale is to benefit the countries with lower income and compensate them for the loss of competition as a policy instruments (it can consist in an inversely proportional weight assigned to some measure based on the per capita income of the member states),

● 3) Finally, it should refer to the consolidated global profits, whereas at the moment it requires the consolidation of only the profits coming from European operations. Thus, the European tax base remains separate from the non-European one, thereby leaving firms the opportunity to exclude intermediary companies located in tax havens, which they use to avoid taxes. Profit shifting and fictitious activities would continue to be a problem that could be dealt with anti-avoidance measures proved so far to be utterly insufficient.

What are the prospects?

Even in a watered down version the project risks never being launched or being scaled down to a project without a C, *consolidated, (*where all that is achieved is a harmonization of the tax base). Ireland, the Netherlands and the UK to varying degrees have detached themselves from the project. Moreover, if it is to be launched the project needs to resolve some significant technical details. It also needs the unanimous vote of the European Council which must not be taken for granted,

And this raises another sore point for European integration, one that requires unanimity of the 28 member states for decisions to be binding in tax matters, plus the assent of the Council of Ministers, the

Commission and the European Parliament. All, with the supposed collaboration of those European countries that have acted as tax havens and continue to attract capital in a.questionable way.

- Unless we overcome the provision of unanimity in fiscal decisions, it will always be difficult to achieve concrete results on these issues, let alone implement policies that are organic and truly European.
- Unanimity can also make it difficult to decide what portion of tax receipts raised under the above system – if administered by the Union – should be devoted to a stronger European budget (that may include receipts from a carbon tax and from tax on financial transactions). A stronger budget is needed to draw resources to compensate those countries that may feel harmed by policies that challenge tax competition. But, of course, it is also designed to achieve other obvious objectives of strengthening the European infrastructure grid and supporting economic activity,

European countries have not lost fiscal autonomy because of globalization but because of internal competition, as has already been stated. They can regain authonomy only if they act collectively. It takes political impetus to address the issues of the principle involved.

Obvously the project aimed at curbing tax competition is not the only one that the EU needs, but is not secondary. If the Eupopean Union continues to allow countries to embezzle each other's tax bases and legitimises the de-industrialization of some to the benefit of others, it embodies a serious distortion that - coupled with prospects of low long run growth and high unemployment - brings it dangerously close to the fire.