The fight against tax fraud and tax evasion (and tax avoidance?)

Clemens Fuest

Centre for European Economic Research, Mannheim (ZEW)

European Economic and Social Committee, Brussels, March 19th 2014
I. Forms of tax evasion/avoidance and the difference between the two

II. How would we like international taxation of multinational firms to work?

III. Will the change in the PSD help?

IV. What else can be done?
I. Forms of tax evasion and avoidance and the difference between the two
Issues related to tax avoidance and tax evasion

1. Taxation of wealthy individuals
   - Tax avoidance (legal): Example: Use of trusts to avoid income taxation (not necessarily offshore)
   - Tax evasion (illegal): Example: Failure to report income from portfolio investment in bank accounts in tax havens;

2. Taxation of multinational companies
   - Tax avoidance (legal): Using debt financing in high tax countries and equity financing in low tax countries
   - Tax evasion (illegal): Failure to declare profits generated in a country with weak tax enforcement
Tax Avoidance by Multinational Companies

- Many numbers in the public domain about the level of tax revenue losses due to avoidance (and evasion) are calculated on the basis of methods which are not up to standards for evidence based policies (example: 1 trn tax revenue loss per year due to tax evasion in the EU)

- But there is solid econometric evidence that multinational companies systematically engage in tax planning to reduce their tax burden

- Meta study (Heckemeyer and Overesch, 2013): Tax difference of 10 percentage points leads to tax base loss of 8% in high tax country, one quarter through financial structures, three quarters through transfer pricing and tax planning involving immaterial property (patents, brands)
II. How would we like international taxation of multinational firms to work?
1. Border Crossing income flows (interest, dividends, royalties) can be taxed in the source country, the residence country, or both.

2. A case can be made for either source or residence based taxation.

3. Pragmatic Approach:
   - Avoid Non-Taxation of Corporate Income
   - Avoid Double Taxation of Corporate Income
III. Will the change in the PSD help?
Overall assessment: It is **very helpful** that we start thinking about the role of residence versus source taxation in the EU.
GAAR-type rule in Art 1a:

- Suspends the ban on source taxes in cases of tax avoidance

- Relies on controversial concept of ‘artificiality’ or ‘artificial arrangements’

- Difficult to identify ‘artificial’ arrangements appropriately – ultimately corporate structures are a matter of entrepreneurial decisions, should not be decided by tax administration
Change of Art 4:

• "(a) refrain from taxing such profits to the extent that such profits are not deductible by the subsidiary of the parent company;

This does not prevent payments going to tax havens via individual member states with favorable DTAs with third countries (tax havens)
IV. What else can be done?
• **Extend the use of source taxes** on interest and royalty payments, with tax credits in the residence country (but this leads to a massive redistribution of taxing rights between countries)

• Redistribution of taxing rights can be limited by **using source taxes but providing a tax credit in the source country which equals the tax in the residence country**, example:

  • **Example:** Royalty payment from Germany to Ireland, Germany levies a source tax of 30% but provides a credit of 12.5% if the royalty is subject to regular corporate tax in Ireland,

• **Note:** This only works if **EU member countries coordinate their DTAs with Non-EU countries**

Available from: http://www.zew.de

or

fuest@zew.de
Thank you very much!