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Post-crisis trends in taxation – twilight or survival of the models?

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We examine corporate tax regulation of several Member States of the single market. The goal is to describe practices that considerably deviate from the mainstream in this regulatory field and potentially endanger the proper functioning of the single market. In particular, we focus on the conformity of the national legislation with the common competition policy providing a level playing field for doing business. Secondly, we desire to identify regulatory outputs that impede a deeper cooperation between the Member States.

In our research we lean on the comparison of national particularities; we identify practices that make jurisdictions attractive for taxation purposes, especially regarding research and development. However, we acknowledge the considerable approximation of national legislations that has taken place in recent years and highlight the role of the European Commission in this process. Finally, we consider the taxation of dividends as this is the main income type serving repatriation.

Keywords: corporate tax, harmful practices, single market

1. Introduction

Ten years have passed since the outbreak of the biggest crisis after the great recession of 1929–1933. The 2008 crisis resulted in shrinking fiscal latitude and serious social consequences throughout Europe. Member States of the European Economic Area, on the other hand, faced significant challenges in regulatory policies. Apart from the loosening of the implementation of the common competition policy, as the cornerstone of European integration, several novelties evolved in the field of corporate taxation as well. We see a dualistic approach in this: Member States struggle to screen their sovereign rights, on the one hand, and, on the other hand, more emphasis is put on European Union level initiatives enshrining the integrity of the single market. We put this duality into the focus of our research.

We concede the importance of corporate taxation in developed economies as this is one the traditional sources of national budgets. During the golden age of corporate taxation – in the sixties and seventies of the twentieth century – higher than 40% tax rates were common in Europe. During these decades corporate tax was mainly considered a revenue source; as a side note we recall that this period overlaps with the evolution of the welfare state. However, globalisation has brought considerable change in corporate taxation as well. Liberalisation of international trade, increased mobility of capital, the development of financial intermediaries, and the emergence of developing economies all contributed to the alteration of taxation in the European region. As a result, the share of corporate tax in budgetary revenues today is not crucial in developed economies, usually representing approximately 10% of total budgetary revenues. Considering this, we argue that currently corporate

taxation rather serves socio-economic goals: it may actuate research and innovation, back the organic development of a sector, contribute to employment and the creation of new workplaces, and, in a broader sense, can increase the attractiveness of the whole economy. In open economies like Member States of the European single market are, the latter is of great importance, although meanwhile we admit the pure fiscal implication of the tax in several economies.

In the confederation of Member States the proper functioning of the single market ensures the integrity of the economic union. In the reading of taxation this means that tax measures might not divert the flow of investments. In other words, states have to refrain from applying tax incentives that artificially separate the place of economic activity and payment of taxes. Tax planning echoes a global phenomenon and reflects "the importance of cross-country spillovers in analyzing corporate tax reform" (IMF 2019, introduction) since allocation of taxation rights, base erosion, and profit shifting, the race to the bottom still create considerable tension on national tax systems. Highlighting these thoughts, we survey those measures that potentially endanger the above-mentioned considerations or may lead to significant deviation from the general patterns. In the paper we encompass the main characteristics of the Irish, Swiss, Dutch, and Luxembourg regulation.

The structure of the paper is as follows. In the first section we give a broad overview of corporate taxation; we review its history, main characteristics, and objectives. In the second section we provide a regulatory-scientific description of the above-mentioned jurisdictions, including the taxation of dividends.

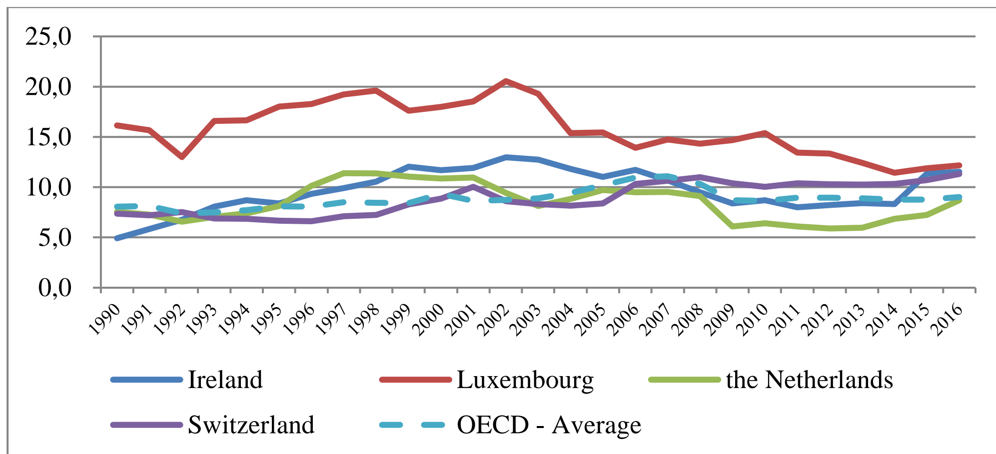
2. Corporate taxation – an overview

According to Bardopoulos (2012) the history of taxation goes back to ancient times with considerable regulatory improvement of the ancient Egyptians and Greeks. Taxes of the initial times served strategic and building goals. Later on, in the nineteenth century, the fundaments of modern income taxation were laid down in the United Kingdom, later on in the United States and in the rest of the developed world. The main novelty of these taxes was the taxation of income realised by the persons in the given jurisdiction i.e. it is being imposed on income-creating business activity.

Although corporate tax rates have decreased significantly during the last decades its share within the total revenues has not fallen significantly over the last two decades. According to the Organisation for Economic Cooperation and Development (OECD) the corporate tax/gross domestic product ratio remained below 3%, however, trends in the post-1990's figures are hard to extrapolate. For example, observing again the most developed countries, the share increased from a stable two-and-a-half percentage value but in the years of the millennium the indicator even passed 3%. The total tax burden, however, shows a diverse picture: it is higher than the OECD average in the Netherlands and Luxembourg, but lower in Ireland and Switzerland (OECD 2018).

A more explanatory indicator, the share of corporate tax within the total tax revenues shows a slightly detailed picture. The share of corporate tax in the most developed countries comes in at only 9% while in developing countries it exceeds 15% in 2016, for instance. However, no organic development can be seen in this indicator (Figure 1). In the case of the economies studied, we rather see a convergence in corporate tax revenues than a decrease; it is also worth mentioning that the average share of corporate tax revenues in the surveyed countries has risen by 1.9 percentage points. Mainly the high Luxembourg value contributed to this effect, but Ireland and Switzerland produced an above-OECD-average outcome, too.

Figure 1 Share of corporate tax within the total tax revenues in selected economies, 1990–2016 (%)



Source: OECD (2019)

The increase in corporate tax within the budgetary revenues, however, is not followed from an increase in tax rates, as the combined corporate tax rate[1] has considerably lowered in Member States surveyed (Table 1). In Ireland, for example, the rate was almost halved in less than two decades, and in the Netherlands lowered by 10%. The increase in total corporate tax revenues therefore can only be attributed to a rise economic activity. From the data available, however, it cannot be deducted whether this is due to growing domestic business output, profit shifting or the broadening tax base (Hines 2005).

[1] We agree that corporate taxation is predominantly related to central budgets. According to Blöchliger and Petzold (2009) tax share of sub-central governments was around 17 percent, half of the resources spent. This increased the dependence of sub-central expenditures on central budgets.

Table 1 Statutory tax rate change in surveyed countries (%)

	2000	2008	2016
Ireland	24	12,5	12,5
Luxembourg	37,5	29,6	29,2
the Netherlands	35	25,5	25
Switzerland	24,9	21,2	21,1

Source: OECD (2019)

Avi-Yonah (2005) identifies three goals of taxation. It includes the fiscal implication of tax collection, the redistributive function, and the shaping of entrepreneurial economic activity. In the economic literature there is a deep debate on the nature of taxes and their impact on business activity. Devereux–Sørensen (2006) argue that the aim of corporate taxation is to gather all income generating activities under the taxable incomes, as solely taxing private individuals' income could lead to non-taxation of several items. Authors also admit that enterprises contribute by this means to common charges, including benefits to infrastructure and human resources. Nowadays fiscal impetus on research, development, and innovation can be considered the most important accessory goal of the corporate tax system. This usually takes place in the form of tax allowance, i.e. a bunch of expenses interrelated to R+D+I can be deducted against an income tax base. We do concede there are further accessory considerations served by a well designed corporate tax system (employment, social development, environmental aspects). From these items, we are mainly dealing with allowances relating to the development of a knowledge-based economy.

We also note the importance of corporate social responsibility (KPMG 2016) in corporate taxation, even if this is generally not embedded into statutory requisites. This feature usually represents a code of conduct on voluntary disclosure of taxation trends, but, broadly speaking, it represents all the countenance an enterpriseplaces outside the framework of legislative compliance.

3. Corporate tax regimes of Member States studied

In this section we overview specialities of the corporate tax regimes of Ireland, Luxembourg, the Netherlands, and Switzerland. We highlight characteristics of the national legislation with the aim of giving a broader insight. As a general rule the single market Member States[2] studied apply principles in corporate taxation consistent with the Model Tax Convention on Income and on Capital issued by the Organisation for Economic Cooperation and Development. Therefore, besides featuring national tax legislation we return to the provisions of this model and Member States' relating to international harmonization. Finally, we examine dividend distribution rules of the Member States mentioned.

[2]We acknowledge that the Swiss Confederation is not part of the single market but is deeply integrated into it through bilateral agreements.

3.1. Overview of corporate tax incentives

We assert that the economies researched impose corporate tax on resident companies' worldwide income. The worldwide income encompasses incomes of entities doing business abroad through permanent establishment or branch, in line with the generally accepted international income taxation principles. Furthermore, companies having a place of management or control in the given jurisdiction are also considered to be resident for corporate tax purposes.

These provisions are, however, subject to double tax conventions, where they exist, deductions or credits granted by jurisdictions. Deductibility reveals the maturity of the tax system and reflects legislative notions regarding economic development. The states studied provide a wide range of deductible costs and expenses against the tax base; these might serve development and financial goals (e.g. start-ups, R+D, royalty payments, and interest, respectively). States also offer taxpayers the possibility to credit taxes, mainly in the field of R+D and investments (PwC 2018). Tax incentives might considerably decrease enterprises' tax liability.

As referred to in the previous chapter we see in numerous jurisdictions that deductions can be made against the corporate tax base with the clear aim of supporting research and development. This instrument is obviously shaped for multinational companies appropriating considerable expense on R+D, however, it can even lead to tax planning. In the Netherlands, for example, an innovation box was created in which, after the approval of the competent authority, 7% tax rate applies to qualified intellectual assets. This advantage is available regarding only non-marketing assets and for groups of companies with revenues over EUR 250 million, and certain further conditions have to be met. On the other hand, a wide range of incomes is considered as qualified and enterprises are allowed to further 30% surplus enforcement. Furthermore, a separate R+D incentive (credit) exists in the Netherlands whereby nearly half of the eligible expenses can be deducted. In Switzerland there is no downright R+D corporate tax incentive, partly because of the confederal state system. Generally, tax incentives are available for activities that support steady economic and social development. Research and innovation is backed by tax incentives in Ireland as well. Thanks to the Knowledge Development Box, an interim tool for supporting knowledge-intensive business activity, eligible companies may deduct certain expenses up to an effective tax rate of 6.25%. Software-related expenses count as qualified together with other high-tech innovation costs (EY 2018). Furthermore, a tax credit is also available in Ireland, whereby one quarter of the research and development expenditures can be credited. In practice, the 25% is accumulated with the normal corporate income tax rate, meaning 37.5% allowance can be realised. Luxembourg made considerable changes to its relevant intellectual property legislation, harmonising it with the latest OECD and EU standards on nexus approach. In fact, patents and software are eligible for the exemption. Thanks to this, the place of effective taxation corresponds to the taxable activity, an 80% exemption is applicable on qualified incomes and taxing at a rate of 5.2%. It is worth mentioning

that other support (loans) is available for enterprises engaged in research and development up to the entire amount (PwC 2018).

We argue that country-specific tax deductions in some cases result in considerable tax relief (Table 2). For instance, in Switzerland 8.5% central governmental tax rate is applicable and an ambulatory local rate imposed by the cantons. The two level combined average tax burden therefore amounts to 22.9%, meanwhile the effective tax rate is 3.4 percentage points lower. Similarly, nearly 10% difference is seen in the innovation friendly Netherlands. While it may be true in the case of several Member States of the European Economic Area that there is an even bigger edge between the statutory and effective corporate income tax rates, these fall outside the scope of the current study.

Table 2 Corporate income tax rates in surveyed countries, 2017 (%)

Tax rate	Central governmental, statutory	Regional/municipal, statutory	Effective tax rate
Ireland	12.5	-	11.8
Luxembourg	20.3	6.8	24.5
the Netherlands	25	-	23
Switzerland	8.5	14.4	19.5

Source: OECD (2019)

The difference between the statutory and the effective tax rates implicates further alleviation for taxpayers. One of the leading Member States is Luxembourg, its magnetism originating in its investment funds. Investment funds, for example, are subject to relatively loose conditions on setup and are exempt of corporate tax, on the one hand, and, on the other hand, some investments (private wealth management enterprises – *Société de gestion du patrimoine familial*) may benefit from extraordinary tax relief (close to zero percent), including exemption from withholding tax as well (EY 2018). Luxembourg also operates venture capital instruments (*Société d'investissementen capital à risques*), targeted to foreign residents, exempting mainly passive incomes and capital gains (PwC 2018).

The tax treatment of funds is, however, not as beneficial in Ireland as it is in Luxembourg (EY 2018). Newly (in 2017) introduced legislation is intended to overcome the non-taxation of real estate funds by burdening the payments with 40% withholding tax. Similarly, offshore funds are taxable as well, subject to several conditions (Member States of the European Economic Area, tax convention in force, etc).

Regarding corporate tax (and, in a broader sense, direct taxes) there has been no far-reaching harmonisation at a supranational level and corporate taxation to some extent embodies the sovereignty of Member States. In the early years of the millennium, the European Union initiated a legislative process with the clear aim of tackling harmful tax competition within the common market, admitting the "need for coordinated action at European level to tackle harmful tax competition in order to help achieve certain objectives such as reducing the continuing distortions in the single

market" (CoC 1997). In the framework of the Code of Conduct, Member States committed themselves to cutting back harmful tax practices and refraining from introducing such measures. We also admit the importance of the Anti Tax Avoidance Directive (adopted in 2016) which "creates a minimum level of protection against corporate tax avoidance throughout the EU" (EC 2019a). The Directive is intended to address behaviours that lead to non- or under taxation in the single market and prescribed measures on controlled foreign companies, new switchover rules, rules on exit taxation and interest limitation, and a comprehensive anti-abuse rule. This set of measures serves national budgetary interests, on the one hand, and, on the other hand, the European Commission – enshrining the uniformity of the single market – intends to preclude the adoption of diverse national acts in this area.

3.2. International interaction of corporate tax systems

According to the recommendation of the OECD, Model Tax Convention states are encouraged to dissolve juridical double taxation, both of income and capital. The Model encompasses direct taxes at all governmental levels; this providing a channel for undistorted business activity. The concept of business activity is defined by domestic law (Rust 2011).

As we referred to in the previous chapter, states impose taxes on enterprises' worldwide income. The motivation behind this is to prevent non-taxation of an income earned by a resident. Tax conventions, on the other hand, share taxing rights of incomes, i.e. align corporate tax (and personal income tax) systems of the contracting parties with the clear aim of avoiding double taxation. Although in the single market, harmonisation is far advanced in the area of indirect taxes, direct taxation has remained a national competence therefore tax conventions settle double taxation between European single market Member States as well.

Two methods of tax reliefs exist for the avoidance of double taxation, both being observed in various EEA tax conventions. The exemption method disregards incomes that are taxed in the partner jurisdiction, but they might be considered in the calculation of other obligations (see progressive exemption). Passive incomes (dividends, royalties, interests) might be excluded from relief and taxed according to the provisions of a tax credit.

Crediting is a rifer method of eliminating double taxation. Thanks to this kind of relief resident taxpayers may credit taxes already paid in the partner jurisdiction. This method serves better contracting parties' budgetary interests, however, poses an administrative burden.

3.3. Taxation of dividends

In this subsection we describe the main characteristics of the dividend taxation in Member States studied. Enterprises repatriate profits by this income type, and therefore its taxation also affects the single market. We feature national acts and the Parent-Subsidiary Directive of the European Union.

According to the legislative practice dividends are taxable in the country where the recipient holds residence for tax purposes. This main rule, however, does not prevent states from taxing dividend incomes in the contracting state where the payee holds residence for tax purposes, i.e. from imposing withholding tax. In Luxembourg, for example, dividends are taxed at the normal rate of corporate tax but exemption is available. A criterion for this is that the dividend payer is subject to the Parent-Subsidiary Directive (other eligibility criteria based on the domestic law widens the scope); while on the payee side there is also a widespread criteria, however in brief, we note that local branches of companies resident in one of the Member States of the European Economic Area Member meet the prescriptions for exemption. In the Republic of Ireland, dividends from other contractual jurisdictions are also taxed on the normal corporate tax rate (currently 12.5%) provided the beneficiary owns at least 5% of the capital in the dividend payer entity. Inland dividend payments are tax free. If, however, the dividend is paid by an Irish company in which less than five persons exert more than 35% of the controlling rights, surtax is payable in some elements of the incomes (PwC 2018).

In the Netherlands dividends are also tax free if the participation reaches at least 5% in the distributor of the dividends and the share does not qualify for portfolio investment. Furthermore, as a main rule there is no withholding tax on dividends paid, subject to notification to the competent authority. In the Swiss Confederation, dividends are generally taxable according to the normal rates of corporate tax but if the beneficial owner of the dividends received holds at least 10% of the shares, it may be eligible for tax exemption. On the other hand, dividend distributions are subject to a 35% withholding tax (PwC 2018, EY 2018).

Table 3 Contractual withholding tax rates between Member States studied, (%)

	Ireland	Luxembourg	the Netherlands	Switzerland
Ireland	0	15; 0/5	0/15	0
Luxembourg	15; 0/5	15/0	2.5/15	15; 0/5
the Netherlands	0/15	2.5/15	0/15	0/15
Switzerland	0	15; 0/5	0/15	35

Source: own research based on PwC (2018)

Note: 1. for Luxembourg the first figure stands for portfolio investments, the second for substantial holdings. 2. between the Member States of the European Union no withholding tax is applicable.

Contrary to corporate income in the case of dividends (and other types of passive incomes) contracting states may collect withholding taxes. It results in a two-way interaction between jurisdictions: the state of the entity distributing dividends is entitled as well to tax the income. This kind of division of taxation rights may lead to friction between the contracting parties, leading the OECD to elaborate recommendations in the Model Tax Convention. Article 10 of the Model as a main rule assigns taxation rights to the state where the recipient is resident for tax purposes. However, the recommendation states that jurisdiction where the distributor is resident may also tax these incomes but at no more than 5% if the beneficial owner (parent company) holds at least 25% of the shares in the distributor. The aim of this limitation is to "avoid recurrent taxation and to facilitate international investment" (OECD 2014).

As seen from the previous paragraphs undistributed taxation rights may lead to legaldisputes between Member States, and in parallel to double taxation of dividend payments. For this reason – and to reduce the distortion of the single market – in the 1990's the European Commission took the initiative and proposed the Parent-Subsidiary Directive (PSD). The Directive's goal is twofold: to eliminate double taxation of the income, on the one hand, and, on the other hand, to cease withholding taxation on dividend payment (EY 2009). In the 2003 amendment of the Directive, considerable amendments were included whereby the scope of covered entities was extended (EC 2019b). Among other legal forms European companies, the newly established institutions were covered by the Parent-Subsidiary Directive. The amendment resulted in a loosening of conditions relating to shares the parents needed to hold in the subsidiary for being eligible for the benefits of the Directive. Currently 10% is the shareholding minimum. The third novelty served the avoidance of double taxation in the case of chain of companies paying dividends by imputing taxes paid by the successive entity. Ashta (2006), however, lists the issues where further legislation would be welcome but these concernmainly national mismatches in tax legislation.

4. Conclusion

The scope of our paper was to show some of the practices that represent special treatment for resident companies. We have given an overview of corporate taxation and dividend withholding taxation, respectively.

We targeted the notion of the single market. Although Switzerland is not a Member State of the European Union, it does participate in the single market and therefore its legislation also affects the flow of capital. An emphasis was put on innovation regimes as this is the bottleneck of corporate tax incentives. We showed tax treatment of the Dutch innovation box, the Irish Knowledge Development Box and the Luxembourger intellectual property regime. With a general overview of the Parent-Subsidiary Directive, it has been shown that thanks to gradual reform, withholding tax on dividends have been abolished and steps taken towards further elimination of double taxation. We consider these acts as developments towards a less fragmented single market.

Summarising, we conclude that there have been considerable attempts on the European Union level to tackle harmful tax competition possibly posed by Member State taxation practices. One of the most prominent examples of this is the Code of Conduct whereby major distortion of the single market has been staved off.

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