

Removal of taxation-based obstacles and distortions in the Single Market in order to encourage cross border investment



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Abstract

The coexistence of 27 different national tax systems in the European Union brings about significant obstacles to cross border business activity in the European Single Market. The objective of this study is to show the context and developments in European secondary law that have led to the current situation or, at least, have not yet resolved it. In addition, perspectives are shown as to how the described obstacles to cross border investment in the Internal Market can be countered both in the short and long term, both at the fundamental and also at the procedural or administrative level.

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LIST OF ABBREVIATIONS

ACC	Allowance for Corporate Capital
ACE	Allowance for Corporate Equity
ATAD	Anti-Tax Avoidance Directive
BEFIT	Business in Europe: Framework for Income Taxation
BEPS	Base Erosion and Profit Shifting
CbC	Country-by-country
CbCR	Country-by-country Reporting
CBIT	Comprehensive Business Income Tax
CCCTB	Common Consolidated Corporate Tax Base
CCTB	Common Corporate Tax Base
CFC	Controlled Foreign Company
DAC	Directive on Administrative Cooperation
DEBRA	Debt Equity Bias Reduction Allowance
DEMPE	Development, Enhancement, Maintenance, Protection, Exploitation
D/NI	Deduction/No Inclusion
DTT	Double Taxation Treaty
EATR	Effective Average Tax Rate
EEA	European Economic Area
ECJ	European Court of Justice
EU	European Union
FDI	Foreign Direct Investment
FDII	Foreign Derived Intangible Income

G20	Group of Twenty
IP	Intellectual Property
ITC	Income Tax Code
MNEs	Multinational Enterprises
OECD	Organisation for Economic Co-operation and Development
R&D	Research and Development
SMEs	Small and Medium Sized Enterprises
TEU	Treaty on European Union
TFEU	Treaty on the Functioning of the European Union
TRACE	Treaty Relief and Compliance Enhancement

EXECUTIVE SUMMARY

Background

The coexistence of 27 different national tax systems in the European Union (EU) brings about significant obstacles to cross border business activity in the European Single Market. This obstacle is at odds with the economic objectives of the European Treaties and also with the ambition set out in the Lisbon Strategy of establishing the "most competitive and dynamic knowledge-based economy [...] in the world"¹.

Aim

The objective of this study is to show the context and developments in European secondary law that have led to the current situation or, at least, have not yet resolved it. In addition, perspectives are to be shown as to how the described obstacles to cross border investment in the Internal Market can be countered both in the short and long term, both at the fundamental and also at the procedural or administrative level.

Key Findings

EU Member States have found it much easier to agree on curbing international tax planning than on reducing tax and administrative barriers in the Single Market. As a consequence, leeway for international tax planning has actually decreased significantly in recent years, but at the cost of a complexity explosion.

For companies active across borders in the Single Market, tax complexity today is not only caused by the sheer heterogeneity of 27 non-harmonised national tax systems in the EU but also by very high transparency and documentation requirements as well as by internationally non-aligned substance criteria that companies must meet to escape from tighter anti-avoidance legislation. Moreover, the actions agreed in the Organisation for Economic Co-operation and Development (OECD) project against base erosion and profit shifting (BEPS), which the EU has implemented at a record pace, especially through its Anti-Tax Avoidance Directive (ATAD), are inherently complex and partly overlap in their scope of application with hierarchies not always being clearly defined. Newly introduced linking rules designed to combat gaps in the taxation of income make the source country tax treatment of a cross border payment dependent on its taxation abroad, potentially over multiple layers of the multinational's group structure. The required deep look along the entire ownership chain of a company, potentially stretching across multiple countries, is costly and complex, both for the taxpayer and the local tax administration.

Low-taxed or even untaxed income has turned out to be a thorn in the European legislator's side. And quite certainly, the fight against specific forms of tax avoidance that generate untaxed, i.e. "white" income, is legitimate and can be justified on systematic grounds: Corporate profits should be taxed exactly once within the international corporation tax system. Just as double taxation of income contradicts the desired functioning of the tax system, so does zero taxation. The result of such deviations from the desired single taxation of income, in one direction or the other, is a distortion of competition in the market.

¹ European Council, Lisbon, 23 and 24 March 2000, Presidency Conclusion, www.europarl.europa.eu/summits/lis1_en.htm, retrieved on 16/05/2022.

However, in seeking to ensure taxation at the “place of value creation”, both the OECD and the EU go beyond this systematically grounded notion of tax aggressiveness, in some cases significantly.

While for the last ten years the fight against tax avoidance has been high on the European policy agenda, the avoidance of double taxation as well as the efficient implementation of EU law prohibiting discrimination and restriction of cross border activity have been less of a concern to the legislator. Some improvements, as in the form of the EU Dispute Settlement Directive, were certainly made. Still, many administrative procedures in cross border taxation, e.g. for the exemption or refund of withholding taxes, are lengthy and costly. Similarly, EU legal requirements and European Court of Justice (ECJ) rulings are implemented hesitantly or defensively by the Member States. Infringement procedures often turn out lengthy and inefficient, too. These deficiencies go as far as preventing taxpayers from initiating procedures that have been put in place to secure their legal rights. In essence, from the point of view of multinational companies active in the Single Market, the EU legislation implementing key impulses from the OECD BEPS project has brought about restrictions in tax-related leeway and a drastic increase in compliance costs without providing facilitation of cross border activity in return. In particular, no fundamental coherence of national taxation systems was achieved. The measures put in place address the consequences rather than the causes of tax-related frictions in the Internal Market and thus remain purely symptom-related. While the ATAD creates some convergence in the set of instruments used to restrict tax-planning leeway resulting from incoherent tax systems, its design as a mere minimum standard implies once again a considerable fragmentation of tax rules in the Internal Market. Other pressure points that matter from a business perspective, such as the question of a cross border loss-offset, have not been resolved despite decades-long discussions. Tax distortions in real investment decisions also persist - in tension with the principle of tax neutrality implied by the economic goals set out in the primary law of the European Union.

Going forward, the EU must position itself in the global competition. The US tax policy has long been characterised by a greater awareness of the realities of international tax competition, providing also carrots and not only the stick for investors. In contrast, the EU stands out globally with a high-speed strategy that almost exclusively centers on the fight against tax avoidance. The ATAD is representative for this endeavour: It is the first EU directive that does not bring any tax advantages for affected taxpayers, but only entails restrictions and costs. Meanwhile, the EU Commission keeps on pressing ahead with the implementation of the projected global minimum tax. However, it is already clear that even with the global minimum tax, the fundamental role of taxation in international location competition is unlikely to become obsolete. On the one hand, this is due to the design of the global minimum tax itself. On the other hand, competition between locations is likely to shift to other tax fields, such as the taxation of highly qualified labour or omitted tax advantages are potentially compensated for by subsidies. The latter route in particular, however, is barred to EU Member States against the background of EU state aid law. This, in turn, puts the EU in a potentially disadvantageous position compared to locations that are more flexible.

Some of the fundamental tax obstacles and distortions in the Internal Market can (only) be addressed by a substantial harmonisation of corporate taxation in the EU. The idea is to establish independent and uniform European regulations for a harmonised profit tax base and then to consolidate group profits with subsequent formula apportionment to the Member States. In 2021, the EU Commission reconfirmed this plan under the new label “Business in Europe: Framework for Income Taxation (BEFIT)”. Within the framework of a Europe-wide uniform corporate tax base, the emergence of qualification conflicts in the Internal Market would be prevented, since the uniform profit determination rules would also regulate the tax treatment of shareholder distributions, the demarcation between equity and debt capital in hybrid financing instruments and the deduction of financing costs. A uniform tax base would also cover consistent rules on loss determination, which

would be an important prerequisite for the further development of group taxation towards cross border loss offsetting.

If the concept of group taxation including consolidation and formulaic profit allocation is not implemented immediately, cross border loss relief could be made possible at an earlier stage of harmonisation. While this certainly would raise questions in terms of revenue implications and budget balancing between Member States, cross border loss offset would be a very strong signal for the competitiveness and attractiveness of the Single Market.

Since formula apportionment annihilates any incentive or starting point for cross border profit shifting in the Single Market, there would no longer be any need for highly complex anti-avoidance measures in the Single Market. In view of the burdensome effects of the ATAD, it seems worth considering extending the scope of application at least of the harmonisation of the tax base to all companies subject to corporate income tax and, in return, withdrawing the ATAD in the Internal Market.

The EU's immediate focus should be on the reduction of actual tax obstacles in the Internal Market. Initiatives already launched by the EU and the OECD to reduce tax compliance costs for taxpayers are therefore to be welcomed and expanded. Besides the urgent need to simplify the relief or refund procedures for withholding taxes in the Single Market, the EU must generally promote harmonised and efficient taxation procedures and the reduction of legal uncertainty in other areas as well. Against this background, it seems fundamentally positive that in the course of the most recent amendment of the Directive on Administrative Cooperation (DAC 7), a legal framework was also created for conducting joint audits between two or more Member States as of 1.1.2024. Joint audits are one aspect of the so-called OECD Tax Certainty Agenda, with the aim to improve legal certainty and application of tax law. Such efforts should be taken up and intensified. In the EU context, it also makes sense to accelerate infringement proceedings by improving the resources and staffing of the responsible bodies.

In order to avoid potential violations of EU fundamental freedoms and subsequent lengthy proceedings, a strong voluntary commitment by the Member States in the sense of a Code of Conduct to a speedy and foreseeable final implementation of European legal requirements could be an important step. In addition, an innovative idea would be for the EU states to agree, at least in principle, to give greater weight to the opening of the Internal Market in the future than has been the case to date in alternative ways of eliminating discrimination by adapting the law.

However, efforts to reduce tax complexity and the associated compliance costs are potentially counteracted by the planned further anti-avoidance measures in the course of BEPS 2.0, in particular the global minimum tax. When designing the further tax measures that will be required if BEPS 2.0 is implemented, procedural issues and the threat of complexity due to interactions with existing anti-avoidance rules should be consistently considered and remedied in order to counteract a further drastic increase in administrative and tax compliance costs as well as the further emergence of double taxation risks. Furthermore, at the latest with the implementation of BEPS 2.0, all plans for the implementation of a digital levy on the part of the EU Commission should be finally abandoned and existing unilateral digital levies in the EU Member States should be withdrawn.

1. INTRODUCTION

The coexistence of 27 different national tax systems in the European Union brings about significant obstacles to cross border business activity in the European Single Market. This obstacle is at odds with the economic objectives of the European Treaties and also with the ambition set out in the Lisbon Strategy of establishing the "most competitive and dynamic knowledge-based economy [...] in the world"².

The objective of this study is to show the context and developments in European secondary law that have led to the current situation or, at least, have not yet resolved it. In addition, perspectives are to be shown as to how the described obstacles to cross border investment in the Internal Market can be countered both in the short and long term, both at the fundamental and also at the procedural or administrative level. The key finding here will be that cross border business activity in the Single Market is confronted with an exceptionally high level of tax complexity and is thus associated with very high administrative and tax compliance costs as well as double taxation risks. This development has recently intensified and continues to do so. It is urgently necessary, both from an internal perspective and from the perspective of global location competition in which the EU finds itself, to provide companies in the EU with legally secure and administrable procedures, guidelines, and requirements. Fundamentally, some of the major tax problems in the Internal Market will not be solved without further harmonisation. Measures taken so far to limit companies' tax leeway resulting from non-coordinated national tax systems and the tax rate differentials in the EU can hardly be solved in purely symptom-related terms without further exacerbating tax complexity in the Internal Market.

This study is structured as follows. Chapter 2 first opens the context by outlining the main stages of positive integration in the area of direct taxation and elaborating the role of the European Court of Justice (ECJ). Building on this, Chapter 3 will describe the tax distortions and obstacles in the Internal Market. Chapter 4 will make recommendations to policymakers on how to improve the situation against the background of the current tax policy context. Chapter 5 summarises the main findings.

² European Council, Lisbon, 23 and 24 March 2000, Presidency Conclusion, https://www.europarl.europa.eu/summits/lis1_en.htm, retrieved on 16/05/2022.

2. TAX LAW INTEGRATION IN THE EU

2.1. Integration phase 1: steps towards market opening

Tax harmonisation does not constitute an independent objective of the EU. In particular, in contrast to indirect taxation, there is no primary-law mandate to harmonise direct taxation. The only legal basis for the harmonisation of direct taxes is the general provision on the approximation of laws [Art. 115 Treaty on the Functioning of the European Union (TFEU)]. Insofar as they go beyond the direct safeguarding of fundamental freedoms, there is broad discretion for measures based on Art. 115 TFEU, which is, however, limited by the need for unanimity and the principle of subsidiarity [Art. 5 (3) Treaty on European Union (TEU)] and must be exercised in consideration of the necessity for a functioning Internal Market. The restrained primary-law mandate and the associated lack of progress in the harmonisation of direct taxes in the EU can probably also be explained by the fact that the competitive relevance of direct income taxes is less direct and thus less obvious than that of indirect taxes.³

After a long negotiation process, the EU adopted a whole package of directives opening up the Internal Market in 1990. These included the Parent-Subsidiary Directive, the Merger Directive and, in the area of tax procedural law, the EU Arbitration Convention.⁴ The Interest and Royalties Directive, which was adopted in 2003, must also be seen in the context of this package of directives⁵. Notably, these steps towards positive integration in the Single Market concentrated exclusively on corporations. The four directives do not apply to sole proprietorships and partnerships and comparable legislation is not foreseeable. Thus, Europe is still far from a level playing field for different legal forms of business.⁶

The Parent-Subsidiary Directive serves to eliminate double taxation in European multinational groups and prohibits the levying of withholding taxes on profit distributions. The Merger Directive facilitates cross border reorganisations in the Internal Market by granting a tax deferral in respect of the hidden reserves realised in these organisational acts. While the Parent-Subsidiary Directive is thus intended to prevent distortions from the periodic taxation of European multinational groups, the Merger Directive focuses on the tax neutrality of aperiodic events. The Interest-Royalties Directive, on the other hand, abolishes all withholding taxes on interest and royalties paid within an EU multinational group. Finally, the EU Arbitration Convention regulates the elimination of double taxation for EU-based companies, which could otherwise result from a unilateral adjustment of transfer prices for intra-group deliveries and services - thus altering the allocation of profits between the group units - by one tax administration without a corresponding counter-adjustment in the other jurisdiction involved. In an extension of the mutual agreement procedures of bilateral treaty law, the directive provides for a clearer time structure with tighter deadlines and an obligation to reach agreement.

³ Hey, J., 2018, *Europäische Steuergesetzgebung zwischen Binnenmarkt und Fiskalinteressen*, in: Lang (Ed.), *Europäisches Steuerrecht*, DStJG 41, Cologne: Verlag Dr. Otto Schmidt, pp. 17–18.

⁴ Council Directive 90/435/EEC of 23 July 1990 recast as Council Directive 2011/96/EU of 30 November 2011; Council Directive 90/434/EEC of 23 July 1990 now codified as Council Directive 2009/133/EC of 19 October 2009; European Union, 1990, *Convention on the Elimination of Double Taxation in Connection with the Adjustment of Profits of Associated Enterprises*, 90/463/EEC.

⁵ Council Directive 2003/49/EC of 3 June 2003.

⁶ Jacobs, O. H., et al. (Eds.), 2016, *Internationale Unternehmensbesteuerung: Deutsche Investitionen im Ausland, ausländische Investitionen im Inland*, Munich: C.H. Beck, p. 181. Russo, R., 2006, *Partnerships and Other Hybrid Entities and the EC Corporate Direct Tax Directives*, European Taxation, p. 478 et seq.

Taken together, these four legal acts form the core of a business-friendly world of EU directives opening up the Internal Market, the primary legal objective of which is the free allocation of production factors (within multinational companies) in the Internal Market.⁷

The Parent-Subsidiary Directive has brought significant cost relief for groups operating across Europe through the abolition of the otherwise definitive withholding taxes on profit distributions. This has made it possible to build up deep equity chains in the Internal Market, because the repatriation of profits along these chains is now taxed to a considerably lesser extent.⁸ The Merger Directive has opened up new perspectives for group tax planning, e.g. by enabling the tax-neutral reorganisation and bundling of European subsidiaries or the tax-efficient establishment of cross border cooperations and joint ventures, e.g. by transferring businesses or shareholdings to a corporation.⁹ Just like the Parent-Subsidiary Directive, the abolition of withholding taxes on intra-group interest and royalty payments through the Interest and Royalties Directive means a real financial relief, insofar as - previously - a withholding tax credit in the creditor state of the payments was not always guaranteed.¹⁰

2.2. Integration phase 2: the fight against tax avoidance

With the financial and economic crisis and, shortly after, the European sovereign debt crisis, the fiscal interests of the EU Member States and the protection of their tax revenues increasingly became the focus of politics and the public. While there had already been (more or less consequential) previous discussions on the question of fair vs. unfair international tax competition, since then the focus has increasingly been on the behaviour of multinational companies rather than governments.¹¹ Since 2012, the European Commission has taken an active role in the fight against international tax avoidance, in particular by taking up the international discussion on the OECD/G20 Base Erosion and Profit Shifting (BEPS) project (2013-2015) and carrying the impulses of the project into the Single Market in a coordinated manner.¹² The EU implemented important results and agreements from the OECD BEPS project at an astonishingly fast pace. For example, the Anti-Tax Avoidance Directive (ATAD) was adopted in 2016 and promptly supplemented by ATAD II.¹³ The ATAD sets minimum standards for regulatory areas for which the OECD BEPS project itself did not define any stringent minimum requirements, but merely formulated recommendations labelled as a common approach or best practice. This was followed by the introduction of mandatory country-by-country (CbC) reporting for multinational companies with a consolidated turnover of more than 750 million euros.¹⁴ Numerous other amendments to the Directive on Administrative Cooperation (DAC) anchored and standardised

⁷ Schön, W., 2015, *Vom steuerlichen Binnenmarkt zum Europa der Finanzämter. Zur Diskussion gestellt: EU-Aktionsplan zur Unternehmensbesteuerung: Ein Weg zu größerer Fairness und Effizienz in der Steuerpolitik?*, ifo Schnelldienst, Vol. 68 (15), p. 3.

⁸ Jacobs, O. H., et al. (Eds.), 2016, p. 181.

⁹ Ibid., p. 186.

¹⁰ Ibid., p. 189. The Interest and Royalties Directive had design flaws that were recognised early on but not remedied, also see Chapter 3.2. Schön, W. (Ed.), 2013, *Eigenkapital und Fremdkapital: Steuerrecht – Gesellschaftsrecht – Rechtsvergleich – Rechtspolitik*, MPI Series in Tax Law and Public Finance, Band 3, Heidelberg: Springer, pp. 72-73. Fuest, C., et al., 2013, *Profit Shifting and "Aggressive" Tax Planning by Multinational Firms: Issues and Options for Reform*, World Tax Journal, Vol. 5, p. 312.

¹¹ Schön, W., 2014, *Leichter auf die Anklagebank*, EY Tax & Law Magazin 02/2014, p. 50.

¹² Already in December 2012, an action plan and two recommendations were adopted to combat tax fraud and tax planning, cf. European Commission, *Action Plan to strengthen the fight against tax fraud and tax evasion*, COM(2012) 722 final; European Commission, *Commission Recommendation of 6.12.2012 on measures to encourage third countries to apply minimum standards of good governance in the tax area*, C(2012) 8805 final and European Commission, *Commission Recommendation of 6.12.2012 on aggressive tax planning*, C(2012) 8806 final.

¹³ Council Directive (EU) 2016/1164 of 12 July 2016 and Council Directive (EU) 2017/952 of 29 May 2017.

¹⁴ DAC 4: Council Directive (EU) 2016/881 of 25 May 2016.

reporting obligations and the international exchange of information on advance cross border rulings and pricing arrangements as well as on cross border tax planning arrangements in the EU.¹⁵

In parallel, the so-called OECD nexus approach to the (preferential) taxation of income from intellectual property (IP) was established in the EU and the revised OECD transfer pricing guidelines with an increased focus on substance and value creation were incorporated into national legislations.

Moreover, in an additional push towards enhanced transparency, multinational groups with a total consolidated revenue of €750 million will be required to publish their CbC reports on the companies' websites.¹⁶

The above list of measures implemented or adopted shows that the main focus of action in this specific phase of integration was on the fight against international tax arrangements deemed to be inappropriate ("aggressive") or abusive, as well as on the creation of increased tax transparency. The dismantling of tax-induced barriers to cross border business activity in the Internal Market, on the other hand, became much less important.¹⁷ This is also reflected in the fact that, in the course of implementing the tax policy agenda of this phase, double taxation risks from non-coordinated anti-avoidance regulations have been accepted; at least their avoidance was not an objective.¹⁸ In particular, with the ATAD in 2016, for the first time a directive was adopted at EU level that does not unfold any tax advantages for taxpayers, but only entails the restriction of room for manoeuvre and increased tax compliance costs.¹⁹ The ATAD has thus set new standards in several respects. The only counterbalance in terms of potential relief for taxpayers are the new possibilities for resolving intra-European double taxation conflicts through mutual agreement and arbitration procedures, which have been improved by the recent EU Dispute Settlement Directive²⁰.

Notably, even the new phase of positive integration, with its focus on anti-avoidance and tax transparency, has brought about no convergence of national taxation systems, but only a convergence of the instruments used to avoid tax planning opportunities resulting from those non-aligned national taxation systems.²¹ The measures thus address the consequences and not the causes of the lack of tax harmonisation in the Internal Market and they remain purely symptom-related.²² Ultimately, however, both double non-taxation and double taxation can only be avoided through harmonisation of the national taxation systems.²³

¹⁵ DAC 3: Council Directive (EU) 2015/2376 of 8 December 2015. DAC 6: Council Directive (EU) 2018/822 of 25 May 2018.

¹⁶ Council Directive (EU) 2021/2101 of 24 November 2021.

¹⁷ Schön, W., 2015, p. 4.

¹⁸ Hey, J., 2017, *Harmonisierung der Missbrauchsabwehr durch die Anti-Tax-Avoidance-Directive (ATAD): Rechtsmethodische, kompetenzielle und verfassungsrechtliche Fragen unter besonderer Berücksichtigung der Auswirkungen auf § 42 AO*, *Steuer und Wirtschaft*, Vol. 94, p. 250. Schnitger, A., Nitzschke, D., Gebhardt, R., 2016, *Anmerkungen zu den Vorgaben für die Hinzurechnungsbesteuerung nach der sog. „Anti-BEPS-Richtlinie“: Systematische Würdigung der Implikationen für den deutschen Rechtskreis*, *IStr*, Vol. 25, p. 960.

¹⁹ Spengel, C., Stutzenberger, K., 2018, *Widersprüche zwischen Anti-Tax Avoidance Directive (ATAD), länderbezogenem Berichtswesen (CbCR) und Wiederauflage einer Gemeinsamen (Konsolidierten) Körperschaftsteuer-Bemessungsgrundlage (GK(K)B)*, *IStr*, Vol. 27, p. 41.

²⁰ Council Directive (EU) 2017/1852 of 10 October 2017.

²¹ Hey, J., 2016, *Harmonisierung der Unternehmensbesteuerung in Europa – Eine Standortbestimmung in Zeiten von BEPS*, *FR* 2016, p. 557. ATAD leads to convergence of instruments, not their full harmonisation. This is due to the minimum protection concept applied.

²² Spengel, C., Stutzenberger, K., 2018, p. 40.

²³ Lang, M., 2013, *„Aggressive Steuerplanung“ – eine Analyse der Empfehlung der Europäischen Kommission*, *SWI*, Vol. 23 (2013), p. 65.

2.3. Negative integration: the role of the ECJ

If one compares the rather small number of market-opening EU legal acts with the number and frequency of measures adopted at EU level and ongoing efforts for the purpose of anti-avoidance and tax transparency (see Chapters 2.1 and 2.2), one may get the impression that EU Member States find it much easier to agree on curbing international tax planning than on reducing tax and administrative barriers in the Single Market.²⁴ In fact, the EU took the path of positive integration in favour of reducing cross border barriers and disparities in the Internal Market rather hesitantly, and in the course of the 2000s the initiative in this respect even largely flagged.

Thus, the role of the ECJ as an important driving force and "engine of integration" in the Internal Market became all the more important.²⁵ The ECJ, as the guardian of compliance with the fundamental freedoms, enforces the prohibitions of discrimination and restrictions arising from these fundamental freedoms and thus can push towards an alignment of direct tax laws of the Member States through such "negative integration". Starting with its landmark *Avoir Fiscal* judgement of 1986, the ECJ has established that – despite their sovereignty in the field of direct taxes – Member States must not infringe the fundamental freedoms. By now, the ECJ has decided more than 400 cases on Member States' rules for direct taxation. Taking into account the principles of proportionality, the ECJ, for example in the *Lankhorst-Hohorst* case (2002), has interpreted and enforced the prohibition of discrimination in the case of rules on shareholder debt financing, in the *Manninen* case (2004) the prohibition of restrictions in the integration of corporation tax into the personal income tax of shareholders, in the *Marks & Spencer* case (2005) and the *Lidl Belgium* case (2008) the prohibition of restrictions in the context of cross border loss recognition, in the *Cadbury Schweppes* case (2006), the prohibition of restriction in the context of controlled foreign company (CFC) legislation, and in the *National Grid Indus* case (2011), the prohibition of restriction in the context of an exit taxation.²⁶

The truth is that the enforcement of the fundamental freedoms in conjunction with some of the market-opening legal acts described above, in particular the Interest and Royalties Directive, gave rise to new tax structuring leeway in the Internal Market. As an important example, in its judgment in the *Cadbury Schweppes* case, the ECJ, in order to protect the freedom of establishment, made the application of the CFC rules subject to the condition of purely artificial constructions without any economic substance.²⁷ As a result, new scope for tax avoidance schemes opened up in the EU, which were no longer threatened by CFC legislation. In particular, these schemes involved the allocation of intellectual property into European low-tax countries.²⁸ The significant increase in the number of preferential tax regimes for income from the exploitation of intellectual property, so-called IP boxes, can also be explained against this background and is an expression of the fact that the EU Member States have taken up tax competition for the mobile tax base associated with the exploitation of IP.

²⁴ Kofler, G., Pistone, P., 2017, *Seminar J: Ist die positive Integration im EU-Steuerrecht wieder auf Schiene? Gedanken in Vorbereitung auf den 71. IFA Kongress in Rio de Janeiro*, IStR, Vol. 26, p. 711. Hey, J., 2018, p. 10.

²⁵ Hey, J., 2018, p. 20. Drüen, K.-D., Kahler, B., 2005, *Die nationale Steuerhoheit im Prozess der Europäisierung*, Steuer und Wirtschaft, Vol. 82, p. 171.

²⁶ CJEU, Case 270/83, French Republic, ECLI:EU:C:1986:37; CJEU, Case C-324/00, Lankhorst-Hohorst GmbH, ECLI:EU:C:2002:749; CJEU, Case C-319/02, Petri Manninen, ECLI:EU:C:2004:484; CJEU, Case C-446/03, Marks & Spencer plc, ECLI:EU:C:2005:763; CJEU, Case C-196/04, Cadbury Schweppes plc and Cadbury Schweppes Overseas Ltd, ECLI:EU:C:2006:544; CJEU, Case C-371/10, National Grid Indus BV, ECLI:EU:C:2011:785.

²⁷ CFC rules are an important instrument to address tax avoidance schemes. Generally, the separation principle, according to which each corporation, as a legal person, is separately taxable in its own right, allows multinational groups to exploit tax differentials across jurisdictions. However, if CFC rules apply, the profits of a foreign subsidiary are immediately taxed at the higher rate of the parent company's home country, annihilating any liquidity or even final tax benefits.

²⁸ Fuest, C., et al., 2013, p. 309 et seq.

Thus, the ECJ's case law does not necessarily lead to a strengthening of tax neutrality in the Internal Market, but can have the opposite effect.²⁹

An equally unfavourable outcome for tax neutrality in the Internal Market could also be observed in the aftermath of the ECJ decision in the Lankhorst-Hohorst case.³⁰ Lankhorst-Hohorst was the most significant ECJ ruling on so-called thin capitalisation rules which countries have enacted to prevent excessive debt financing of inbound subsidiaries by their foreign shareholders. The Court held that a thin capitalisation rule applying exclusively to non-residents but not to domestic lenders contravened the freedom of establishment.

In order to ensure compatibility with EU law in a post Lankhorst-Hohorst world, EU Member States could either extend the scope of application of their thin capitalisation rules to include resident lenders or limit their scope to exclude EU resident companies altogether. Eventually, Member States showed asymmetric responses. Those with higher rates of corporate tax tended towards widening the scope of application of the thin capitalisation rules to include purely domestic cases, whereas low-taxing Member States tended to exclude intra-EU situations from their scope. Consequently, tax neutrality decreased with effective tax burdens in high tax vs. low tax countries drifting further apart.³¹ Ultimately, the ECJ only decides on the "whether" and not on the "how" of eliminating discrimination and restrictions. In fact, as in the example of the Lankhorst-Hohorst decision just mentioned, the reaction of at least some of the Member States is to downgrade the discriminatory regulation criticised by the ECJ, so that the worse treatment of cross border transactions compared to the domestic case is not eliminated by abolishing the disadvantageous regulation but by extending it to domestic transactions.³² As a result from this type of reaction, the systematics of the national tax law systems suffers.³³

Tax-induced distortions of cross border investment decisions cannot be eliminated solely by the prohibitions on restrictions and discrimination derived from the EU fundamental freedoms.³⁴ The ECJ cannot itself establish coherence of the legal systems and guarantee a treatment of cross border activities that conforms to the ideals of the Internal Market.³⁵ In other words, there are limits to negative integration. As a consequence, a comprehensive harmonisation of Member States' tax systems by way of positive integration, i.e. through deliberately negotiated secondary EU law, would be necessary to sustainably eliminate tax obstacles to cross border business activities. However, as the ECJ can push countries only in very limited ways to further cooperation, potential tax harmonisation is a political question and not a question of the law.³⁶

²⁹ Bräutigam, R., et al., 2017, *Decline of CFC Rules and Rise of IP Boxes: How the European Court of Justice Affects Tax Competition and Economic Distortions in Europe*, Fiscal Studies, Vol. 38, pp. 719-745.

³⁰ Spengel, C., et al., 2020, *Breaking Borders? The European Court of Justice and Internal Market*, ZEW Discussion Paper No. 20-059, Mannheim, p. 9 et seq. De la Feria, R., Fuest, C., 2016, *The Economic Effects of EU Tax Jurisprudence*, European Law Review, pp. 44-71.

³¹ De la Feria, R., Fuest, C., 2016, Ch. 4.2.

³² Hey, J., 2016, p.556.

³³ Jacobs, O. H., et al. (Eds.), 2016, p. 229.

³⁴ Spengel, C., et al., 2020. Spengel, C., 2003, *Internationale Unternehmensbesteuerung in der Europäischen Union: Steuerwirkungsanalyse – Empirische Befunde – Reformüberlegungen*, Düsseldorf: IDW Verlag, p. 257.

³⁵ Hey, J., 2018, p. 21.

³⁶ Spengel, C., et al., 2020, pp. 34-35. Hey, J., 2020, *Taxation of Business in the EU: Special Problems of Crossborder Losses and Exit Taxation*, in: Panayi/Haslehner/Traversa (Eds.), *Research Handbook on European Union Taxation Law*, Cheltenham: Edward Elgar Publishing, p. 204.

3. TAXATION-BASED OBSTACLES AND DISTORTIONS IN THE SINGLE MARKET

3.1. Tax-induced distortions in investment decisions

Companies operating across borders are confronted with up to 27 different tax jurisdictions in the EU. Moreover, the EU Member States compete heavily for capital investment and national tax policy evidentially constitutes an important distinguishing feature in this competition. In fact, several empirical studies have identified a more vigorous tax competition within the EU than in other regions.³⁷ Over the past 25 years, this competition has led countries to reduce their corporate income tax rates while at the same time broadening their income tax bases (“tax rate cut cum base broadening”). In particular, interest deduction limitations and loss compensation rules have become relevant instruments of tax base broadening.³⁸

After all, the continued non-harmonised income tax rates and profit determination rules lead to significant variation in nominal and effective tax rates across the EU. This international tax rate differential within the Internal Market is in tension with the guiding principle of tax neutrality, which, from a tax perspective, is actually implied by the goals of the TFEU and the strategic objective of the European Union.³⁹ The ideal of tax neutrality is fulfilled if taxpayers undertake exactly those investment projects which earn the highest gross returns. Investors, however, base their decisions on after-tax returns. For tax neutrality to be achieved, the ranking of investment alternatives on the basis of after-tax returns must thus lead to such location and investment decisions that priority is given to exactly those investment projects with the highest gross returns. If, instead, due to differences in tax treatment, investments with lower gross returns are carried out at the detriment of more profitable investment projects or locations, the efficient allocation of capital in the Internal Market is disturbed.⁴⁰ In addition, taxpayers incur considerable planning costs when taxes have to be taken into account in the decision-making calculus.

Tax neutrality in the sense just described, that the ranking of domestic or foreign investment and location alternatives does not change even when taxes are taken into account, is achieved under the paradigm of capital export neutrality⁴¹. In principle, capital export neutrality can be achieved even in the case of diverging local income tax rates. The prerequisite is that taxation follows the so-called residence principle. For this purpose, profits earned abroad would have to be determined according to domestic regulations, included in the domestic tax base at the time of assessment and subjected to the same tax rate as domestic profits (if necessary with crediting of foreign taxes). However, the realisation of the residence principle encounters obstacles that are difficult to overcome. This is especially true in the case of participations in foreign corporations because these foreign corporations can shield profits from taxation in their shareholders’ residence country by retaining them (separation principle).

³⁷ Bräutigam, R., et al., 2019, *The Development of Corporate Tax Systems in the European Union from 1998 to 2017: Qualitative and Quantitative Analysis*, Intertax, Vol. 47, pp. 536-537. Devereux, M.P., Loretz, S., 2013, *What Do We Know About Corporate Tax Competition?*, National Tax Journal, Vol. 66, pp. 745-773.

³⁸ Bräutigam, R., et al., 2019, p. 545.

³⁹ Jacobs, O. H., et al. (Eds.), 2016, p. 223.

⁴⁰ Ibid., p. 226.

⁴¹ A capital export neutral tax system taxes the investment of a specific investor at the same level, irrespective of where the investment is conducted.

Moreover, there is no legal entitlement or obligation on the part of the Member States to implement the residence principle, and thus capital export neutrality. Neither the fundamental freedoms under EU law nor the Parent-Subsidiary Directive give priority to capital export neutrality. On the contrary, EU Member States actually prefer an alternative neutrality paradigm, namely capital import neutrality.⁴² As the European Member States exempt profits distributed by (foreign) subsidiary corporations completely or largely from tax at the level of the parent corporations, the foreign subsidiary tax level becomes final. Capital import neutrality is attractive - especially for high-tax countries: Under this paradigm, a company that invests in a certain country is not exposed to a different tax burden than its foreign competitors active in the respective country. These are arguments in favour of capital import neutrality especially from the perspective of export-oriented companies and export-oriented states. Moreover, capital import neutrality allows local tax incentives for investment to work. Ultimately, such rather pragmatic arguments have helped capital import neutrality to gain international acceptance.⁴³

Table 1 shows, using the example of a Belgian parent corporation, the effective average tax rate (EATR) of an investment in the home market Belgium as well as the effective average tax rates on investments in subsidiary corporations alternatively in the 26 other Member States of the EU.⁴⁴

There is a tax differential from an EATR of 1.3 per cent in Malta up to an EATR of 29 per cent in Germany and Spain. The bottom row of Table 1 shows the mean value of the effective average tax rate in all 27 possible investment locations and the dispersion of the effective burdens around their mean value, i.e. the standard deviation. A standard deviation of zero would mean that the tax burden was independent of the investment location, i.e. capital export neutrality would be realised from a Belgian perspective. However, the observed standard deviation of 6.3 is obviously significantly different from zero. While this example refers to the international tax rate differential from the perspective of a Belgian parent corporation, the results would be almost identical for any other European parent country. Tax efficiency in the sense of capital export neutrality is not realised in the Single Market.

Table 1: Effective average tax rates in the Single Market from the perspective of a Belgian multinational parent corporation, 2021

Investment country	EATR (in %)	Investment country	EATR (in %)
Home (Belgium)	23.2	Latvia	18.2
Austria	23.1	Lithuania	12.7
Bulgaria	8.9	Luxembourg	21.9
Croatia	14.8	Malta	1.3
Cyprus	13.3	Netherlands	22.6
Czech Republic	17.0	Poland	16.8
Denmark	19.8	Portugal	21.2
Estonia	11.2	Romania	14.7

⁴² A capital import neutral tax system taxes investments in a specific country at the same level, irrespective of the residence country of the investor.

⁴³ Ibid., pp. 22 and 28. Scheffler, W., 2009, *Internationale Betriebswirtschaftliche Steuerlehre*, Munich: Vahlen, p. 42. Spengel, C., 2013, *Neutralitätskonzepte und Anreizwirkungen im Internationalen Steuerrecht*, in: Achatz, M. (Ed.), *Internationales Steuerrecht*, DStUG 36, Cologne: Verlag Dr. Otto Schmidt, pp. 55-56.

⁴⁴ Spengel, C., et al., 2021, *Effective Tax Levels Using the Devereux/Griffith Methodology – Final Report 2021*, EU Commission, Mannheim. For a detailed explanation of the underlying methodology, please refer to Appendix B of that report.

Investment country	EATR (in %)	Investment country	EATR (in %)
Finland	19.6	Slovakia	18.7
France	28.1	Slovenia	17.3
Germany	29.0	Spain	29.1
Greece	21.0	Sweden	18.7
Hungary	11.0	(UK)	(20.1)
Ireland	14.1	<i>Mean</i>	<i>18.1</i>
Italy	23.9	<i>Standard deviation</i>	<i>6.3</i>

Source: Spengel, C., et al., 2021, Effective Tax Levels Using the Devereux/Griffith Methodology – Final Report 2021, EU Commission, Mannheim.

Empirical evidence shows that the international tax rate differentials multinational companies or international investors are confronted with do indeed have an impact on their investment and location decisions. As expected, investors in capital import-neutral tax systems react much more sensitively to location-specific tax burden differences than under capital export neutrality.⁴⁵ Numerous studies have documented the tax influence on investment decisions of multinational companies.⁴⁶ One empirical study specifically examined the extent to which the tax sensitivity of investments differs between industries.⁴⁷ The results from this study are shown in Table 2. The values indicated in the table represent so-called tax rate elasticities. A tax rate elasticity indicates by how many per cent the stock of foreign direct investment (FDI) in a country decreases if the country's effective tax rate increases by one per cent. For example, the value of -0.689 found across all observations in the study's data sample means that an effective tax rate increase by one per cent (i.e. from 25 per cent to 25.25 per cent) leads to decrease in the capital stock held by foreign investors of about 0.689 per cent. The results depicted Table 2 show that investments in the financial service sector and in research and development (R&D) projects are particularly tax sensitive.⁴⁸ Moreover, if a company only invests in one foreign investment project (rather than several), it cares most about the potential tax implications.

Table 2: Tax sensitivity of foreign investments according to type of activity

Type of activity	Tax rate Elasticity	Type of activity	Tax rate Elasticity
All observations	-0.689***	Vertical FDI	-0.795***
Manufacturing	-0.697*	Horizontal FDI	-0.604***
Non-manufacturing	-0.789***	Manufacturing, vertical	-1.066***
Heavy industry	-0.883***	Manufacturing, horizontal	-0.601*
Non-heavy industry	-0.589	Non-manufacturing, vertical	-0.720**
Business services	-0.369	Non-manufacturing, horizontal	-0.637***

⁴⁵ Atwood, T. J., et al., 2012, *Home Country Tax System Characteristics and Corporate Tax Avoidance: International Evidence*, The Accounting Review, Vol. 87, pp. 1831-1860. Egger, P., et al., 2015, *Consequences of the New UK Tax Exemption System: Evidence from Micro-level Data*, The Economic Journal, Volume 125, pp. 1764-1789.

⁴⁶ Feld, L. P., Heckemeyer, J. H., 2011, *FDI and Taxation: A Meta-Study*, Journal of Economic Surveys, Vol. 25, pp. 233-272.

⁴⁷ Overesch, M., Wamser, G., 2009, *Who Cares About Corporate Taxation? Asymmetric Tax Effects on Outbound FDI*, The World Economy, Vol. 32, pp. 1657-1684.

⁴⁸ The significant tax sensitivity of R&D activities applies both in terms of the quantity of R&D projects and in terms of the quality of the R&D projects. Ernst, C., et al., 2014, *Corporate Taxation and the Quality of Research and Development*, International Tax and Public Finance, Vol. 21, pp. 694-719. Bloom, N., et al., 2002, *Do R&D tax credits work? Evidence from a panel of countries 1979-1997*, Journal of Public Economics, Vol. 85, pp. 1-31.

Type of activity	Tax rate Elasticity	Type of activity	Tax rate Elasticity
Wholesale trade	-0.518	Parent manufacturing, vertical	-1.333***
Financial services	-1.856***	Parent manufacturing, horizontal	-0.597**
Research & development	-1.508**	Single foreign investments	-1.601***
Holding companies	-0.230	Multiple foreign investments	-0.619***
Residual group	-0.082		

Source: Overesch, M, Wamser, G, 2009, Who Cares About Corporate Taxation? Asymmetric Tax Effects on Outbound FDI, The World Economy, Vol. 32, p. 1682.

Notes: A tax rate elasticity indicates by how many per cent the stock of foreign direct investment in a country decreases if the country's effective tax rate increases by one per cent. *, **, *** denote statistical significance at the 10%, 5%, 1% significance levels, respectively.

3.2. Leeway for international tax planning

It has been known for a long time that companies active across borders have the possibilities and leeway to reduce their tax burden through suitable structuring. Group tax planning and the structures set up within its framework derive their legitimacy from the business principle of avoiding unnecessary costs. This principle does not apply differently in the tax area, but just as it does in other functional areas of the company, such as procurement or production planning. Tax planning is not only legal and legitimate, but expressly permitted and provided for. The entrepreneurial aim of maximising the after-tax financial returns from one's own business activities makes good business and macroeconomic sense.⁴⁹

Unlike illegal tax evasion, in which tax is reduced by not declaring income and assets - i.e. by fraud - tax planning uses the legal leeway within the existing law. The spectrum ranges from necessary structuring measures to avoid international double taxation via the exploitation of international tax rate differentials in the sense of tax arbitrage to the targeted exploitation of taxation loopholes and eventually to borderline cases of legally abusive structuring that undermine the meaning and purpose of the law. Where in this spectrum the borderline between acceptable or unacceptable, also "aggressive" tax planning runs, is difficult to determine in a generally valid manner due to the lack of clear demarcation criteria. For example, taking into account the international tax rate differential when financing foreign investments can certainly not be considered aggressive per se. On the other hand, it is understandable if the limit of what is acceptable is not only considered to be exceeded in the case of abusive or even illegal behaviour. From a systematic perspective, one can argue on the basis of the desired functioning of the tax system: Just as double taxation of international corporations with corporate tax is undesirable, so is no taxation of their profits at all. Rather, the goal within the corporate tax system must be to tax all profits exactly once. Structuring which, by exploiting hybrid elements (e.g. financing instruments, legal forms) and the resulting qualification conflicts, generate so-called "white income", i.e. entirely untaxed profits, in a targeted and artificial manner, i.e. not motivated by the

⁴⁹ Jacobs, O. H., et al. (Eds.), 2016, pp. 885 and 891. Also according to the case law of the ECJ, the taxpayer must generally be free to organise his business activity in a tax-optimal way: CJEU, Case C-589/13, F.E. Familienprivatstiftung Eisenstadt, ECLI:EU:C:2015:612. Kahlenberg, C., Vogel, N., 2016, *Unionsrechtsvereinbarkeit der durch Korrespondenzregeln ausgelösten Ungleichbehandlung? Eine Untersuchung des BEPS-Aktionspunkts 2*, Steuern und Wirtschaft, Vol. 93, p. 295 et seq.

economic circumstances, runs counter to this principle and is therefore unacceptable.⁵⁰ Still, with their ambition to ensure taxation at the "place of value creation," both the OECD and the EU go beyond this understanding, in some cases significantly. However, answering the question of the place of value creation in multinational companies is by no means trivial and it cannot be determined objectively and reliably.⁵¹

Some companies that have succeeded in collecting their profits in the form of "white income", particularly in Europe, are known by name, as are the tax arrangements they have used. What most of these prominent cases have in common is that they centre on the exploitation of valuable intellectual property. Through the strategic location of intellectual property (IP) in the group, the interconnection of companies and the charging of - due to the Interest and Royalties Directive - withholding tax-free royalty payments for the use of the IP, taxable profits of the operationally active group companies are reduced to almost zero. Zero taxation, i.e. ultimately also the tax exemption of the royalty income corresponding to the deducted royalty payments, is then achieved by exploiting international taxation incongruities. On the one hand, some states, such as Ireland, linked tax residence solely to the place of management, while other states, such as the USA, based it solely on where the company was incorporated. This meant that companies could be configured that were resident in Ireland from a US perspective, while from an Irish perspective there was no tax residency. The second tax incongruence resulted from the fact that companies were partly transparent or disregarded for tax purposes from a US perspective, while they were recognised as a taxable entity from an Irish perspective. Ultimately, this hybrid entity treatment made it possible to avoid taxation under the US CFC legislation. Essentially, this structure led to a situation which is, according to OECD BEPS terminology, referred to as "D/Ni" – deduction (D) (of royalty payments) in one county but no inclusion (NI) of corresponding income in another.⁵²

This type of structure is just one example - but while we know that there are other ways to shift profits to low-tax jurisdictions, these IP- and licence-based profit shifting strategies, as described, seem to have been the most important profit shifting channel.⁵³ And indeed, robust empirical evidence shows that ownership of intangible assets, patents in particular, within multinational companies is often located where the tax burden is comparatively low.⁵⁴

Taxes affect a company's cost of capital. The cost of capital describes the minimum pre-tax return that a business investment must earn in order to add value from an investor's perspective. The cost of capital is also an important measure of a company's competitiveness, because it provides an indicator of the long-term price floor of a project.

⁵⁰ Fuest, C., et al., 2013, pp. 316-317. Heckemeyer, J. H., Spengel, C., 2013, *Maßnahmen gegen Steuervermeidung: Steuerhinterziehung versus aggressive Steuerplanung*, Wirtschaftsdienst, Vol. 93, pp. 363-366.

⁵¹ Schön, W., 2014, p. 24. Fuest, C., 2020, *Unternehmen am Ort der Wertschöpfung besteuern – eine neue Leitidee für die internationale Besteuerung?*, ifo Schnelldienst, Vol. 73 (3), p. 6 et seq. In principle, the place of value creation can be the place where the group companies have their registered office or management, as well as the place where real investments are made and production facilities and employees are located. Also disputed is the extent to which the customers or consumers, and thus the market states, are involved in the creation of value. The delimitation of the place of value creation is becoming increasingly difficult, especially against the backdrop of digitalisation, as it is possible for companies to generate profits through the use of various technologies without having a physical establishment.

⁵² Fuest, C., et al., 2013, p. 309 et seq. In practice, this type of structure has become particularly known under the name of "Double Irish with a Dutch sandwich".

⁵³ Heckemeyer, J. H., Overesch, M., 2017, *Multinationals' Profit Response to Tax Differentials: Effect Size and Shifting Channels*, Canadian Journal of Economics, Vol. 50, 2017, p. 984 et seq.

⁵⁴ Dischinger, M., Riedel, N., 2011, *Corporate Taxes and the Location of Intangible Assets within Multinational Firms*, Journal of Public Economics, Vol. 95, pp. 691-707. Karkinsky, T., Riedel, N., 2012, *Corporate Taxation and the Choice of Patent Location within Multinational Firms*, Journal of International Economics, Vol. 88, 176-185. Griffith, R., et al., 2014, *Ownership of Intellectual Property and Corporate Taxation*, Journal of Public Economics, Vol. 112, pp. 12-23.

A company that pays little tax on its investment returns has a lower cost of capital and can thus lower its prices compared to its competitors in the market.⁵⁵ However, a distortion of competition occurs not only in the sales markets, but also in the market for corporate acquisitions.

For example, companies that can significantly avoid income taxation are better able to self-finance acquisitions even at very high prices and can thus outbid potential competitors.⁵⁶

One-time taxation of profits can thus be justified with tax-systematic and economic arguments. According to the literature, however, there is no direct provision of EU law to ensure one-time taxation, just as there is no direct provision to avoid international double taxation.⁵⁷

The measures agreed in the course of the OECD BEPS project and successively implemented at high speed in the EU address the neuralgic aspects of international tax planning described above; however, in line with EU's rather broad understanding of aggressive tax planning (see above), they go overall beyond what is necessary to ensure one-time taxation.

First of all, it was an important concern to encourage countries to strengthen their residence taxation. This was done, on the one hand, through the mandatory introduction of CFC legislation that meets minimum standards (Art. 7 and 8 ATAD, BEPS Action 3) and, on the other hand, by linking preferential tax regimes for income from the exploitation of intangible assets, the IP boxes, to the existence of local research and development activities (so-called OECD nexus approach).⁵⁸ In turn, taxation in the source state has been expanded through the mandatory introduction of thin capitalisation rules that meet minimum standards (Art. 4 ATAD, BEPS Action 4), i.e. restrictions on the tax deductibility of interest in the case of debt financing of local group companies that is deemed excessive. The focus of such deduction restrictions is less on combating legal abuse than on the steering effect against undesirable financing structures, regardless of their economic justifiability. Following a similar logic, Austria and subsequently also Germany introduced (partial) deduction restrictions for royalty payments.⁵⁹ Another field of action to strengthen taxation in the source countries was the revision and adaptation of the OECD Transfer Pricing Principles (BEPS Actions 8-10), with a particular focus on the valuation of intangible assets and the associated royalties. Another important issue is the allocation of income from intangible assets, which is based on the assumption or use of the so-called DEMPE⁶⁰ functions in the group. These functions, i.e. the value added they contribute, must be adequately remunerated within the group.⁶¹

Qualification conflicts in hybrid mismatch arrangements and the associated gaps in the taxation of cross border payments have their origin in the diversity of national tax systems and their different, non-

⁵⁵ Spengel, C., 2003, pp. 67-68.

⁵⁶ A notable case study from 2011 is Microsoft Corp.'s acquisition of the European company Skype for a price of \$8.5 billion, which was considered very high given the business fundamentals at the time, paying that sum entirely out of overseas cash held in low-tax countries such as Bermuda and Ireland. (<https://www.forbes.com/sites/ericavitz/2011/05/10/microsoft-with-skype-a-good-use-for-the-giant-overseas-cash-pile/?sh=4257bb826b34>)

⁵⁷ Kahlenberg, C., Vogel, N., 2016, p. 297. Hagemann, T., Kahlenberg, C., 2017, *BEPS und Doppelbesteuerung*, in: Nienhüser, W., Schmiel, U. (Eds.), *Jahrbuch für Ökonomie und Gesellschaft, Steuern und Gesellschaft*, Band 29, pp. 342-343.

⁵⁸ OECD, 2015, *Countering Harmful Tax Practices More Effectively, Taking into Account Transparency and Substance, Action 5 - 2015 Final Report*, OECD/G20 Base Erosion and Profit Shifting Project, OECD Publishing, Paris.

⁵⁹ Heckemeyer, J. H., Hemmerich, A. K., 2021, *Unilaterale Abzugsbeschränkungen als Gegenmaßnahme zur IP Steuerplanung in Europa - Eine empirische Analyse der österreichischen Lizenzschranke*, *Steuer und Wirtschaft*, Vol. 98, pp. 217-231.

⁶⁰ DEMPE: Development, Enhancement, Maintenance, Protection, Exploitation.

⁶¹ Ullmann, R., et al., 2022, *Funktionale Zuordnung nach DEMPE: Diskussion einer Einordnung und DEMPE-Schwelle*, *Der Betrieb* 4/2022, pp. 148-156.

coordinated income determination and income allocation rules. In order to neutralise the undesirable effects of hybrid arrangements, so-called "linking rules" were introduced (Art. 9, 9a and 9b ATAD, BEPS Action 2). These rules aim at a corresponding, i.e. coherent tax treatment of payments in the debtor state and the recipient state. This presupposes a corresponding knowledge of the tax treatment in the respective other state.⁶²

Another important field of action in recent years has been the improvement of tax transparency. In the course of the so-called country-by-country reporting (CbCR), groups of companies with consolidated sales revenues of more than € 750 million must annually and for each affected tax jurisdiction separately report, among other things, the revenues, the pre-tax profit, the income taxes and the number of employees in a country-by-country report (DAC 4, BEPS Action 13). Furthermore, the regulations on transfer pricing documentation have been considerably expanded. In addition to country-specific, company-related documentation of business relationships, large multinational enterprises must also document the worldwide business activities of the group and the applied system of transfer pricing determination. The objective of these transparency measures is to increase the incentive to comply with the transfer pricing regulations and to provide information already at an early stage that is helpful for identifying transfer pricing risks or conducting tax audits.⁶³ In addition, it was agreed that in the future, states will inform each other without prior request about tax rulings they issue to taxpayers in the run-up to cross border transactions (DAC 3, BEPS Action 5). In addition, taxpayers or their advisors are now obliged to disclose cross border tax arrangements to the tax authorities (DAC 6, BEPS Action 12).

A comprehensive, holistic evaluation of the effectiveness of BEPS measures is not available. The available empirical evidence relates to individual instruments. Basically, the existing studies document that instruments are indeed effective in reducing the specific undesired corporate tax planning behaviour they target. For example, interest deduction restrictions effectively reduce the incentive to use internal loans for tax planning, the Austrian licence barrier reduced affected cross border licence flows, and effective CFC legislation leads to a decline in passive investments in low-tax countries.⁶⁴ The OECD modified nexus approach effectively prevents excessive reductions of the tax burden of multinational enterprises (MNEs).⁶⁵ Country-by-country reporting leads to increased creation of substance and a decline of artificial structures.⁶⁶ Stricter transfer pricing guidelines and documentation requirements also restrict this channel of profit shifting.⁶⁷

However, the empirical studies do not directly record and measure any second-round effects and indirect side effects. For example, the symptom-related action pluralism described above gives rise to

⁶² Jacobs, O. H., et al. (Eds.), 2016, p. 1280 et seq.

⁶³ Ditz, X., et al., 2016, *Die neuen Pflichten zur Dokumentation von Verrechnungspreisen nach dem Regierungsentwurf des Anti-BEPS-Umsetzungsgesetzes v. 13.7.2016*, IStR, Vol. 25, pp. 789-797.

⁶⁴ Buettner, T., et al., 2012, *The Impact of Thin-Capitalization Rules on the Capital Structure of Multinational Firms*, Journal of Public Economics, Vol. 96, pp. 930-938. Heckemeyer, J. H., Hemmerich, A. K., 2021. Ruf, M., Weichenrieder, A., 2012, *The Taxation of Passive Foreign Investment: Lessons from German Experience*, Canadian Journal of Economics, Vol. 45, pp. 1504-1528. Egger, P., Wamser, G., 2015, *The Impact of Controlled Foreign Company Legislation on Real Investments Abroad. A Multi-Dimensional Regression Discontinuity Design*, Journal of Public Economics, Vol. 129, pp. 77-91.

⁶⁵ Müller, J. M., Spengel, C., Steinbrenner, D., 2021, *European Union – IP Box Regimes and Multinational Enterprises: Does Nexus Pay Off?*, World Tax Journal, Vol. 14, pp. 75-112.

⁶⁶ De Simone, L., Olbert, M., 2021, *Real Effects of Private Country-by-Country Disclosure*, The Accounting Review, forthcoming.

⁶⁷ Marques, M., Pinho, C., 2016, *Is Transfer Pricing Strictness Deterring Profit Shifting within Multinationals? Empirical Evidence from Europe*, Accounting and Business Research, Vol. 46, pp. 703-730. Beer, S., Loeprick, J., 2015, *Profit Shifting: Drivers of Transfer (Mis)pricing and the Potential of Countermeasures*, International Tax and Public Finance, Vol. 22, pp. 426-451.

considerable complexity, a sharply increasing tax compliance burden and double taxation risks from the potential interaction of the various regulations (see Chapter 3.3).

It should also be noted that the effective restriction of international tax planning leeway and thus the reduced possibility of profit shifting to low-tax countries can result in an increasing tax sensitivity of real investments. If profits can no longer be shifted across borders, the underlying economic activity must be allocated to low-tax locations from the outset in order to optimize the tax consequences.⁶⁸ As a result, international tax competition for real investments might even intensify. The continuing downward trend in corporate income tax rates in Europe since the adoption of the BEPS reports in 2015 supports this hypothesis.

3.3. Tax complexity, compliance costs, and risk of double taxation

Recent research divides the main drivers of tax complexity for multinational companies into two main pillars: tax code complexity and tax framework complexity. Tax code complexity captures the complexity of the tax code and covers complexity drivers which are linked to specific tax regulations, such as regulations on CFC legislation or on transfer pricing. Tax framework complexity describes features and procedures that do not relate to single regulations but to the entire corporate income tax system.⁶⁹ Table 3 lists and describes the specific underlying drivers of each of these two main pillars according to this research.

Based on this conception of complexity, a survey-based evaluation of tax complexity from the point of view of transnational companies is used to construct an index that measures tax complexity on a scale from zero to one.⁷⁰ The following Figure 1 shows the complexity index for 26 EU Member States and the EU average as of the year 2020, with index values included for Switzerland, the United Kingdom and the United States as comparative benchmarks.⁷¹ The graph shows quite a dispersion of tax complexity across EU Member States with Finland showing the lowest level of overall tax complexity and Croatia, closely followed by Belgium and Italy, featuring the highest tax complexity with an index value of about double that of Finland. Still, even the least complex tax system in the EU features a tax system that, according to the index data, is more complex than the tax system in Switzerland. Remarkably, the EU average level of tax complexity exceeds the complexity level of relatively simple tax systems such as in Finland and Switzerland by about 50%. Interestingly, the UK's tax complexity is below the EU average while the United States features a tax system that is more complex than the European average.

Tax complexity and compliance costs are highly correlated and thus the very high level of tax complexity in the Single Market with non-harmonised direct taxes across 27 Member States, tight anti-abuse legislation and increasing requirements with regard to documentation and transparency, certainly weighs heavily on companies that are active or consider to become active across borders in

⁶⁸ Overesch, M., 2009, *The Effects of Multinationals' Profit Shifting Activities on Real Investments*, National Tax Journal, Vol. 62, pp. 5-23. Hong, Q., Smart, M., 2010, *In Praise of Tax Havens: International Tax Planning and Foreign Direct Investment*, European Economic Review, Vol. 54, pp. 82-95.

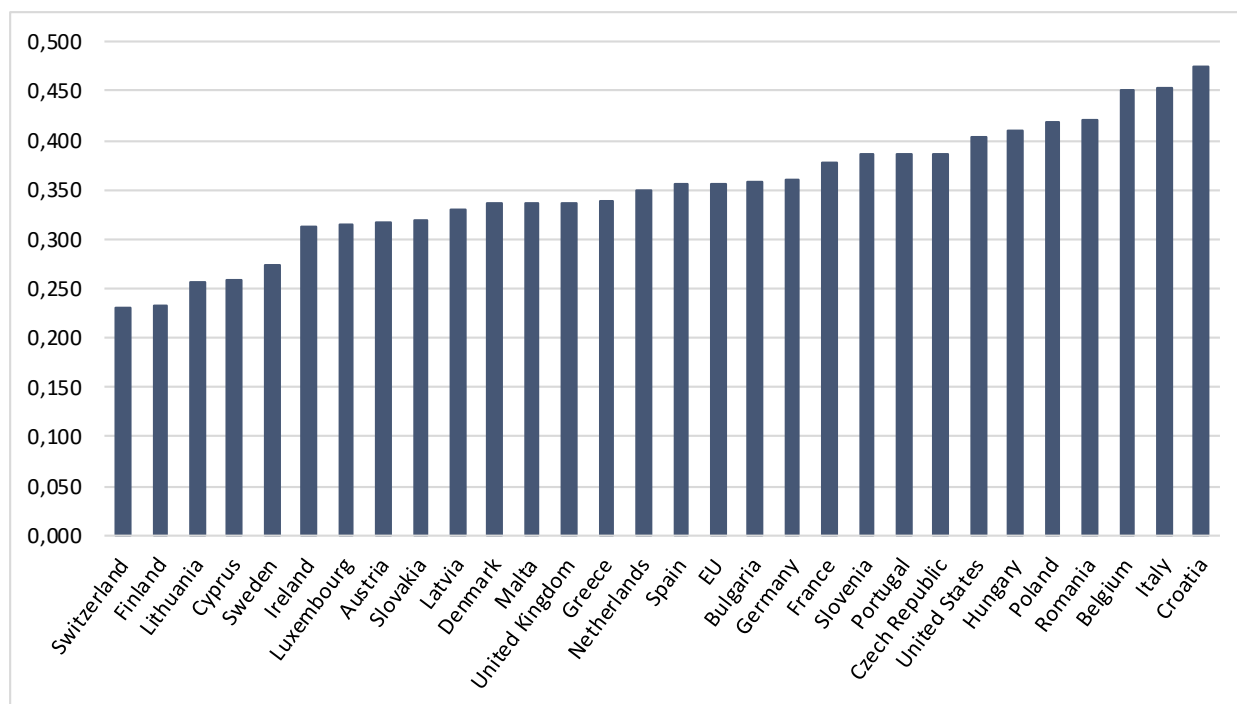
⁶⁹ Hoppe, T., et al., 2018, *What are the Drivers of Tax Complexity for MNCs? Global Evidence*, Intertax, Vol. 46, p. 666 et seq.

⁷⁰ Hoppe, T., et al., 2021, *The Tax Complexity Index – A Survey-Based Country Measure of Tax Code and Framework Complexity*, European Accounting Review. The survey consists of 52 standardized questions, covers 100 countries and it has been conducted among 933 highly experienced tax consultants of the largest international tax services networks.

⁷¹ Index data taken from www.taxcomplexity.org. Index is calculated using equal weights for all complexity dimensions. Details with regard to the underlying methodology are provided in Hoppe, T., et al., 2021. No data is available for Estonia.

the Single Market. According to a recent EU Commission study, companies in the EU (plus UK) are estimated to spend an annual total amount of EUR 204 billion to comply with obligations related to CIT, VAT, wage related taxes and contributions, property and real estate taxes and local taxes. This roughly equals to 1.3% of the GDP of these countries.⁷²

Figure 1: Tax Complexity Index, 2020



Source: Author's own elaboration.

Notes: Index data was taken from www.taxcomplexity.org. Index is calculated using equal weights for all complexity dimensions. Details with regard to the underlying methodology are provided in Hoppe, T., et al., 2021. No data is available for Estonia.

Table 4 lists and explains significant complexity-related problems for businesses in the Internal Market that are known from practice literature and practice dialogue. As it is possible to use the framework presented in Table 3 to classify these problems, Table 4 also indicates for each complexity-related problem the concrete underlying complexity driver according to the classification known from Table 3.

⁷² European Commission, Directorate-General for Internal Market, Industry, Entrepreneurship and SMEs, European Innovation Council and SMEs Executive Agency, Di Legge, A., Ceccanti, D., Hortal Foronda, F., et al., 2022, *Tax compliance costs for SMEs: an update and a complement: final report*, p. 133.

Table 3: Drivers of tax complexity for multinational companies

Name of complexity driver	Description
<i>Tax code complexity</i>	
1. Ambiguity & Interpretation	When a regulation is phrased in an unclear, imprecise and/or ambiguous manner so that different interpretations are possible.
2. Change	When a regulation is frequently changed and the changes are extensive in terms of quantity and/or scope.
3. Computation	When many and/or complex calculations are needed to determine the (non-)applicability of a regulation and/or the specific tax treatment.
4. Detail	When a regulation contains excessive details, such as numerous rules, exceptions to rules and/ or cross-references to other rules.
5. Record keeping	When many records and documents must be kept to substantiate all claims under a regulation and/or to complete the tax return.
<i>Tax framework complexity</i>	
6. Tax law enactment	<p>The process of writing and enacting tax legislation.</p> <ul style="list-style-type: none"> ➤ Changes that apply retrospectively to ongoing and closed transactions ➤ Quality of tax law drafting, i.e. the tax legislator drafts tax law that requires intervention by tax courts ➤ Pieces of legislation that contradict each other or overlap with uncertainty over their interaction
7. Tax guidance	<p>Describes instances in which no (sufficient) guidance exists to facilitate the application of a regulation.</p> <ul style="list-style-type: none"> ➤ Guidelines are not issued, not made publicly available or when they are not helpful or contradictory. ➤ Lack of alignment between tax norms: Different meanings for the same word or different tax treatments for the same transaction.
8. Tax audits	<p>Complexity of tax audits is strongly driven by the skill and experience of the tax inspectors and the resulting quality in terms of how they apply the law and how they pursue their inspection.</p> <ul style="list-style-type: none"> ➤ Are tax inspectors competent enough to understand highly complex business transactions? ➤ Do tax inspectors behave aggressively and with a focus on collection of revenue even if audit outcomes are incoherent?
9. Tax appeals	<p>Complexity is driven by inconsistent application of the law.</p> <ul style="list-style-type: none"> ➤ Lack of specialized tax courts or a specialized appellate body ➤ Length of the time the appeals process takes is a major problem, both at the administrative and the judicial level, for example due to a lack of resources. This creates a less stable and less certain environment.
10. Tax filing and payments	<p>Complexity is created by the sheer number of tax payments and the administrative procedure associated therewith.</p> <ul style="list-style-type: none"> ➤ The forms/appendices provided by the tax authorities for filing purposes are very specific and lengthy and/or need to be handed in more than once a year. ➤ Numbers of tax payments can be a problem especially in countries where companies are required to withhold taxes and remit them to the tax authorities. ➤ Even e-payment systems introduced to facilitate tax payments can create problems if there is a lack of common technology between companies and tax authorities

Source: Hoppe, T., et al., 2018, What are the Drivers of Tax Complexity for MNCs? Global Evidence, Intertax, Vol. 46, p. 666 et seq.

Table 4: Complexity induced obstacles for cross border investment

Complexity induced obstacle	Description and examples	Primary complexity dimensions affected (Table 3)
Heterogeneity of national tax systems	The heterogeneity of national taxation systems makes for high information and tax compliance costs in the Internal Market. This heterogeneity or fragmentation of tax law in the Internal Market has, incidentally, not diminished as a result of the ATAD, but has even been exacerbated due to its design as (only) a minimum standard, with the corresponding consequences for compliance costs for internationally active companies that have to inform themselves about and comply with a potential variety of regulations.	All dimensions
The procedures for exempting or levying and refunding withholding taxes are lengthy and costly.	The procedures for exemption or refund of withholding taxes under double tax treaties (also between third parties) and under the Parent-Subsidiary Directive or the Interest and Royalties Directive (only within groups) are very lengthy and complex. In some cases, companies are reluctant to even initiate these procedures, which actually serve to relieve their tax burden. These difficulties undermine the purpose of the withholding tax relief and imply a financial barrier for inbound investments.	Dimensions 7, 10
Hesitant or defensive implementation of EU legal requirements or ECJ rulings	<p>Requirements of EU law are sometimes only hesitantly or not conclusively taken into account in legislation. This leads to long periods of legal uncertainty.</p> <p><i>Example 1:</i> German anti-treating shopping rule (§ 50d (3) German ITC). Anti-treating shopping regulations are, by definition, in tension with the freedom of establishment in the Internal Market, because they are intended to make the involvement of foreign companies less attractive under circumstances that are considered to be abusive. The German regulation as of 2007 was considered to be in violation of EU law and the legislator amended the law as of 2012. However, in two decisions (CJEU, Joined Cases C-504/16 and C-613/16, Deister Holding AG and Juhler Holding A/S, ECLI:EU:C:2017:1009; CJEU, Case C 440/17, GS, ECLI:EU:C:2018:437.), the ECJ declared that amended version of the German regulation to be contrary to EU law, too. A new version of the regulation was introduced as of 2021.</p> <p><i>Example 2:</i> For many years, the German legal norms on fiscal groups for income tax purposes have been suspected of not meeting the requirements of primary EU law. In particular, non-resident EU/EEA subsidiaries with management in Germany were excluded from the benefits of the German corporate income tax regime for fiscal groups. The EU Commission found this to be a violation of EU rules on freedom of establishment and started infringement proceedings. In 2013, the German tax group was opened up to EU/EEA subsidiaries with their effective place of management in Germany. In purely formal terms, the situation had been resolved. In practice, however, the administration continued the discriminatory practice notwithstanding the opening of the personal scope of application by not recognising a profit and loss transfer agreement concluded with a foreign legal entity, a mandatory requirement of the tax group under German law. This discriminatory administrative practice, which ultimately only shifted the problem from the tax level to the corporate law level, was in turn the cause of new infringement proceedings.⁷³</p>	Dimensions 2, 6

⁷³ Boller, T., Hackemann, T., 2020, *Die ertragsteuerliche Organschaft erneut auf dem Prüfstand der EU-Kommission*, IStR, Vol. 29, pp. 41-46.

Complexity induced obstacle	Description and examples	Primary complexity dimensions affected (Table 3)
Lengthy infringement procedures with sometimes inefficient allocation of competences and resources	<p>From the taxpayer's point of view, the possibility of reporting infringements of Union law via infringement proceedings is - in principle - a valuable alternative to court proceedings, which are fraught with litigation costs. However, this option is spoiled for the taxpayer by the fact that infringement proceedings take an extremely long time. For example, there are currently cases pending before the ECJ that date back to 2006. The long duration of infringement proceedings becomes particularly problematic when the tax treatment of a matter, which has remained unresolved for so long, is relevant to a decision within a statutory period.</p> <p><i>Example:</i> The German legislator grants a so-called roll-over relief for the tax-neutral transfer of hidden reserves in the case of the sale and re-acquisition of certain assets. The re-acquisition must take place in the next four years. If, in a cross border case, the granting of roll-over relief is potentially denied in breach of EU law, the infringement proceedings brought to clarify the matter might take longer than the period in which the investor must decide on reinvestment.</p> <p>Infringement proceedings regularly concern highly complex tax law issues. To be effective, such proceedings at the EU Commission should be handled by persons who are familiar with the respective national tax law. Overall, responsibilities and resources for the purposes of infringement proceedings should be optimally allocated.</p>	Dimension 9
Inconsistent interpretation of legal terms in the cross border tax context	The inconsistent interpretation of legal terms in the Internal Market is associated with a high degree of legal uncertainty. In double taxation treaty (DTT) law, the uniform interpretation of terms from treaty law plays an essential role. Despite fundamentally uniform definitions under DTT law, a uniform interpretation is not always ensured in concrete cases of application, even between the EU Member States. For example, the states may not apply uniform standards to the affirmation a permanent establishment.	Dimension 1
The tax-neutral return of capital contributions is very difficult to achieve and is not guaranteed in the end.	The repayment of capital contributions previously made to a corporation does not constitute an appropriation of profits, but must be made in a tax-neutral manner for systematic reasons. In order to separate the return of capital contributions from profit distributions, the updating of a so-called contribution account is necessary, which tracks the development of the tax equity capital. The evidence requirements for the examination of the return of capital contributions depend on the requirements of the investor's country of residence. However, the requirements of, for example, the German tax authorities are highly complex up to the point that they cannot be fulfilled due to the lack of a corresponding contribution account at the foreign company. As a result, the return of contributions may be treated as a distribution of profits and tax neutrality is therefore not guaranteed.	Dimensions 3, 5, 7
High requirements and obligations to provide evidence for a substance escape from anti-avoidance rules	<p>Under EU law, certain arrangements can be considered to be an abuse of rights and can also be restricted under the fundamental freedoms if they are set up purely artificially to achieve a tax advantage. Conversely, arrangements are permissible if they are based on economic substance. The EU substance exceptions, both in the area of, for example, CFC legislation and in the context of the anti-treaty/anti-directive-shopping regulations, must be asserted in sometimes very complex and thus costly procedures.</p> <p>The requirements with regard to substance may also vary between tax administrations of different countries in the Single Market.</p>	Dimensions 3, 5

Complexity induced obstacle	Description and examples	Primary complexity dimensions affected (Table 3)
Very high transparency and documentation requirements as well as obligations to provide proof	Increased transparency and documentation requirements demand considerable additional compliance effort, especially if the stricter requirements are to be applied retroactively to all open cases. These increased requirements came along with the adaptation of national transfer pricing regulations to the standards of the OECD Transfer Pricing Guidelines as well as, for large companies, with the obligation to submit a CbCR report. For example, the application of the DEMPE concept in transfer pricing is associated with a very high level of complexity, as can be seen from the fact that its explanation in the OECD guidelines takes up 53 paragraphs and 29 examples on 52 pages of text ⁷⁴ .	Dimensions 5, 8
Linking domestic tax consequences with tax consequences abroad can be quite demanding	In order to avoid taxation incongruities as a result of qualification conflicts in hybrid arrangements, the ATAD Directive provides for linking rules in the sense that the tax treatment of a payment in the source country is made dependent on its tax treatment abroad. In this context, very complex situations are conceivable, so that it may be necessary to examine foreign tax treatment over several stages in an international group. Compliance under such circumstances can be very resource-intensive and the case may be difficult to understand also for the tax auditors involved.	Dimensions 3, 4
Multiple BEPS actions with not always clarified regulatory interaction and resulting double taxation risks	The avoidance of double taxation is not a primary concern of the EU in the course of implementing its agenda for increased tax avoidance and tax transparency. For example, the linking rules introduced to prevent tax loopholes in hybrid arrangements can compete with other anti-avoidance rules such as restrictions on interest deductions or CFC rules. While the OECD recommendations originally developed in the BEPS reports provided for conflict-of-law rules, the ATAD does not contain such an application hierarchy. An overlapping of the rules with a corresponding risk of double taxation therefore cannot be ruled out per se ⁷⁵ . Moreover, the minimum standards for anti-avoidance legislation defined in the ATAD are not designed to and actually do not avoid potential double taxation. For example, Germany has used its legislative leeway keeping the critical low tax threshold for the purpose of the German CFC legislation at a level of 25%, which is quite high against the backdrop of an EU average profit tax rate of 21.7 % and, due to reasons inherent in the German tax system, implies double taxation of CFC income if foreign source country taxes range between 15% and 25%.	All dimensions

Source: Author's own elaboration.

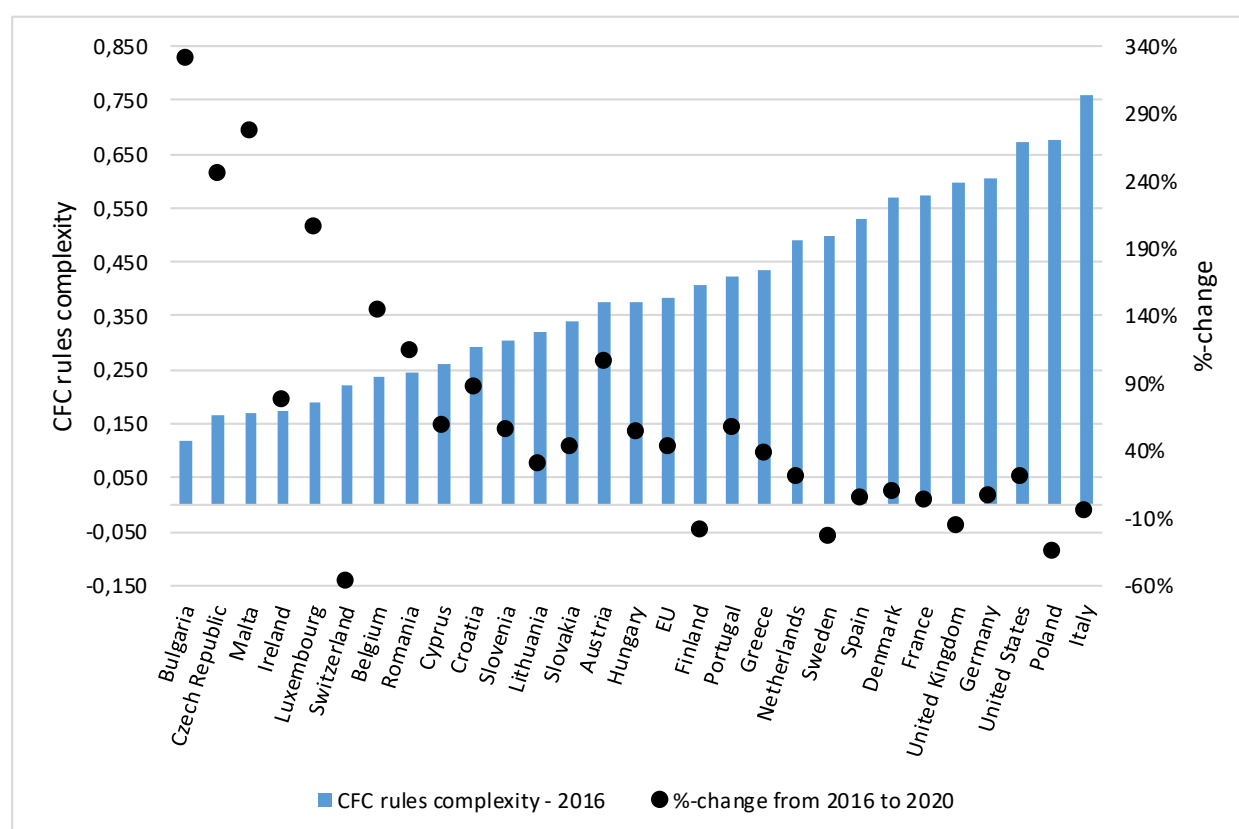
⁷⁴ Bärsch, S.-E., et al., 2016, *Die Dokumentation von Verrechnungspreisen und das Country-by-Country Reporting: Die neuen Anforderungen der OECD und der EU*, Der Betrieb 2016, pp. 972-982. Oestreicher, A., 2020, *Umsetzung überarbeiteter OECD-Verrechnungspreisleitlinien 2017 bis 2020 in deutsches Recht – Teil 2: Empfehlungen für eine Doppelbesteuerung vermeidende Reform der „Berichtigung von Einkünften“*, IStR, Vol. 29, p. 579.

⁷⁵ Hagemann, T., Kahlenberg, C., 2017, p. 355 et seq.

Table 4 highlights important examples of key complexity drivers for cross border business activity in the Single Market. It has become clear that complexity quite often correlates with legal uncertainty. There is empirical evidence that both complexity and legal uncertainty act as barriers to investment. In particular, tax framework complexity is negatively related to inbound foreign direct investment.⁷⁶

The fact that the BEPS measures have a complexity-increasing effect in affected policy areas can also be seen on the basis of the corresponding sub-indices of the Tax Complexity Index, where available. Figure 2 shows the percentage change of the complexity index from the year 2016 to 2020 as black dots, especially with regard to the index sub-dimension that measures complexity of CFC regulations. According to ATAD, each EU Member State must maintain CFC rules that adhere to binding minimum standards. For many EU Member States, this has implied new or enhanced CFC rules with associated drastic increases in complexity; where this increase has not occurred, the CFC-related complexity was already high before implementation of the ATAD, i.e. as of 2016 (in blue bars).

Figure 2: Complexity Index for CFC rules



Source: Author's own elaboration.

Notes: Black dots represent per cent changes (right y-axis) in complexity index for CFC rules from 2016 to 2020. Blue bars represent level of complexity for CFC rules (left axis) as of 2016. Index data was taken from www.taxcomplexity.org. Index is calculated using results for CFC rules only. Details with regard to the underlying methodology are provided in Hoppe, T., et al., 2021. No data are available for Estonia and Latvia.

⁷⁶ Hoppe, T., et al., 2020, *The Relation Between Tax Complexity and Foreign Direct Investments: Evidence Across Countries*, TRR 266 Accounting for Transparency Working Paper Series No. 13.

3.4. The tax treatment of cross border losses

Simply put, the question of the current treatment of cross border losses in light of the fundamental freedoms is whether losses incurred in one Member State may be deducted from taxable profits in another Member State. Academics and practitioners alike consider the persisting restrictions on cross border loss offset as one of the most significant impediments to cross border investment.⁷⁷

Figure A-1 in the Annex illustrates the effect of cross border loss compensation (through a group taxation regime) on the cash tax rate of a multinational company⁷⁸. Without a tax group, the two subsidiaries respectively in country A and B are taxed separately. In order to focus on the time and liquidity effect of immediate loss compensation, let's assume that the corporate income tax rates in country A and B are equal at 25%.⁷⁹

In the example shown in Figure A-1, the multinational group's cash tax rate of no less than 50% by far exceeds the effective tax rate as the tax due of 25 occurs for an overall group profit of 50. The loss of the subsidiary in country A leads to a deferred tax which, however, cannot be used in the present tax period. In order to offset the loss of the subsidiary in country A against profits in country B in the same year, the subsidiary in country B can be established as the controlling holding company of a tax group in country B. If loss compensation is also possible with foreign group members, the losses of the subsidiary in country A can be offset against the profits in country B at the level of the controlling regional holding. The cash tax rate now decreases drastically and now equals the effective tax rate of 25%, reflecting the reduced current tax expense and associated liquidity outflow.

Although providing taxpayers with a clear benefit that facilitates risky cross border investment, cross border loss compensation is rather the exception than the rule in the Single Market. The main reason for the prevailing fragmentation of the Internal Market with regard to tax loss relief lies in the principle of territoriality.⁸⁰ The ECJ's case law on cross border losses reflects the tension between the interests of the taxpayer on the one hand and a balanced allocation of the Member States' taxation rights on the other.⁸¹ In the ECJ's view, the latter recital makes the disallowance of a cross border loss offset appear proportionate in principle. Under certain circumstances, however, the court considers the cross border recognition of final losses – i.e. losses that can no longer be offset otherwise – to be necessary as a last resort.⁸²

The question of cross border loss recognition shows the limits of negative integration as it can be advanced by the ECJ.⁸³ Proportionality considerations, if at all, only lead to an endorsement of the cross border recognition of *final* losses.

⁷⁷ Hey, J., 2019, p. 194. Dreßler, D., Overesch, M., 2013, *Investment Impact of Tax Loss Treatment – Empirical Insights from a Panel of Multinationals*, International Tax and Public Finance, Vol. 20, pp. 513-543.

⁷⁸ The example is taken from Endres, D., Spengel, C., 2015, *International Company Taxation and Tax Planning*, Alphen aan Den Rijn: Kluwer Law International, p. 485.

⁷⁹ In case of an international tax rate differential, cross border loss compensation might additionally allow for tax arbitrage through loss trafficking if not prevented by an anti-abuse clause or a pro rata loss allowance. Maiterth, R., 2006, *Das EuGH-Urteil „Marks & Spencer“ und die grenzüberschreitende Verlustverrechnung aus ökonomischer Sicht*, DStR 2006, pp. 915-919. Hey, J., 2006, *Die EuGH-Entscheidung in der Rechtssache Marks & Spencer und die Zukunft der deutschen Organschaft – Haben die Mitgliedstaaten den EuGH domestiziert?*, GmbH 2006, Vol. 97, p. 116.

⁸⁰ Hey, J., 2019, pp. 195-196. Under the territoriality principle, a residence state does not exert its tax jurisdiction on foreign profits. As foreign profits are thus exempt from taxation in the residence state, it seems logical that, symmetrically, the residence state does not take into account foreign losses either.

⁸¹ Ibid., p. 203 et seq. and p. 211.

⁸² CJEU, Case C-446/03, Marks & Spencer plc, ECLI:EU:C:2005:763; CJEU, Case C-414/06, Lidl Belgium GmbH & Co. KG, ECLI:EU:C:2008:278; CJEU, Case C-650/16, A/S Bevol and Jens W. Trock ApS, ECLI:EU:C:2018:424.

⁸³ Hey, J., 2019, p. 211. Brauner, Y., et al., 2015, *Ten Years of Marks & Spencer*, Intertax, Vol. 43, p. 306.

And even this important impulse of the ECJ and the accompanying expert discussion⁸⁴ has never really caught on in European tax practice. In practice, the tax authorities regularly do not recognise case constellations that have been brought forward and taking legal action before the ECJ is not a good option for taxpayers in view of its lengthiness, its costs and the unclear legal outcome. In the context of a tax group, cross border loss offset between group companies is only permitted in Denmark, France, Italy and Austria. Even today, after decades of discussion, the European Union is still a long way from common standards and harmonised rules for taking into account losses of permanent establishments and subsidiaries located in other Member States.

3.5. Interim conclusion: pressure points and their evolution over time

Looking back at Chapters 2 and 3, it can be said that integration in the area of direct taxation went through various phases. Phase 1 (see Chapter 2.1) brought the first steps of positive integration with a focus on opening up freedoms in the Internal Market. At the same time, or only slightly delayed, the ECJ emerged as an important driver of negative integration (see Chapter 2.3). The tax-related pressure points and barriers to cross border investment and business activity in the Single Market have been elaborated in previous sub-chapters. It became clear that these pressure points were touched or addressed in different ways during the different stages of integration. Table 5 below summarises important insights in this regard. A plus sign indicates a strengthening or aggravation of the problem mentioned in the respective column heading, a minus sign signals a weakening and a zero indicates an essentially unchanged relevance when all trends are taken into account.

It is true that the market-opening package of directives from 1990 and 2003 brought tax relief for intra-group profit repatriation or interest and royalty payments, as well as in the case of corporate restructuring in the Internal Market. At the same time, with the rise of capital import neutrality in international taxation, the tax irrelevance actually aimed for in the Internal Market was never achieved or was even reduced. The driving forces behind the latter development were the move away from the imputation system towards exemption in the case of intercompany dividends, the pushback on CFC legislation as a result of the ECJ's Cadbury Schweppes ruling and the simultaneous emergence of preferential tax regimes, especially for income from intellectual property. Even the subsequent second phase of integration, with its focus on anti-avoidance legislation and tax transparency, did not bring any significant change with regard to the tax distortion of international investment decisions. On the contrary, in view of the energetic curbing of international tax planning leeway, which so far had made it possible, at least within certain limits, to shift income from the source states to low-tax countries or avoid profit taxation at all, an increasing relevance of international tax differentials in investment decisions in the Internal Market seems plausible.⁸⁵ The development of tax rates observed in recent years does not indicate a decline in tax competition for real capital; on the contrary, the governments of important European economies such as France or Belgium have decided to lower significantly their corporate tax rates in recent years.

⁸⁴ See, e.g. Lüdicke, J, Rödel, S., 2004, *Generalthema II: Gruppenbesteuerung*, IStR, Vol. 13, p. 554.

⁸⁵ It remains to be seen to what extent the planned global minimum taxation under BEPS 2.0 can counteract this. However, it is unlikely that competition between tax locations in all its conceivable forms will generally cease. See also Chapter 4.1.

Table 5: Pressure points in the Single Market and their evolution over time

	Tax distortions in investment decisions	Leeway for international tax planning	Tax complexity, compliance costs and risk of double taxation	Cross border loss offset
Integration phase 1: steps towards market opening	+	+	o	O
Integration phase 2: fight against tax avoidance	+	-	++	O

Source: Author's own elaboration.

Notes: -/+ /++/o: decrease/increase/very strong increase/no change in relevance of pressure point.

Considering the tax planning leeway for multinational companies, there are indeed opposing tendencies in the two integration phases under consideration. For example, the directives opening up the Internal Market, especially with the non-neutral withholding tax exemption of interest and royalty flows through the Interest and Royalties Directive, have fostered IP-based tax planning in conjunction with the Cadbury/Schweppes ruling of the ECJ which has limited the application of CFC rules in the Internal Market to abusive, i.e. artificial, arrangements and ultimately also favoured the emergence of new preferential tax regimes in the EU. This contrasts with the very stringent and speedy implementation of the agreements from the OECD-BEPS project in the subsequent phase of positive integration in the Internal Market. It cannot be denied that the comprehensive packages of measures taken over the recent years have at least a limiting, if not an overshooting, effect on the behaviour of multinational companies. These are finding their tax planning leeway effectively restricted, and the efforts of their tax departments and external advisers are increasingly being directed towards compliance requirements rather than the exploitation of international tax differentials. In return, tax complexity and the associated costs and uncertainties for companies operating across borders in the Internal Market have increased dramatically in the course of this latest phase of integration. Even in the earlier phase of market opening, there was no effective relief for companies in this respect due to, e.g. inefficient administrative procedures. However, the increased documentation and reporting requirements, as well as the sheer volume of BEPS measures that companies have to comply with, have increased tax complexity in the Single Market far beyond what was previously the case.

With regard to cross border loss offsetting in the Internal Market, this important barrier to cross border investment has existed for decades without significant progress despite important impulses from the ECJ. Negative integration is visibly reaching its limits here in view of the tension between the fiscal interests of the Member States and the interests of taxpayers, which cannot be resolved by recourse to the fundamental freedoms.

3.6. Spotlight I: small and medium sized companies

Small and medium sized enterprises (SMEs) can be defined and distinguished from larger companies based on either qualitative or quantitative criteria. While qualitative criteria focus, for example, on actively managing owners, they appear often too vague to be consistently applied in practice. The most prominent and widely used SME definition – as put forward by the European Commission – therefore employs three *quantitative* criteria to distinguish four different size classes. Enterprises are classified as either micro, small, medium-sized or large according to their number of employees, annual turnover and balance sheet totals⁸⁶.

Considering the tax induced barriers to cross border investment in the Single Market that most disproportionately affect SMEs, compliance costs certainly stand out. In essence, compliance costs are incurred for acquiring external expertise (e.g., tax advisers) and for hiring employees who take care of tax related obligations within the company⁸⁷. Tax complexity and compliance costs weigh particularly heavily on SMEs. Importantly, a substantial share of the compliance burden is made up of fixed and quasi-fixed costs. Moreover, large enterprises benefit from economies of scale and learning effects stemming from the volume and the frequency of their operations and related tax obligations. As a consequence, the compliance burden (relative to turnover or total assets) decreases in firm size and micro and small enterprises are subject to a disproportionately high compliance burden⁸⁸. Recent evidence shows that firm size is indeed the only clearly identifiable determinant of the *relative* tax compliance burden, i.e. the costs incurred relative to a company's sales or size of the balance sheet⁸⁹. Therefore, the tax systems put SMEs at a competitive disadvantage that would not exist in the absence of taxation and that increases with higher tax complexity.

Moreover, SMEs are not only negatively affected by disproportionate tax complexity costs. Additional non-tax and also tax-related impediments put them at a disadvantage vis-à-vis larger firms.⁹⁰ For example, loss offset restrictions – such as the non-existence of a loss-carryback or the existence of a time limit on loss carry-forwards – affect SMEs more severely than large enterprises. Such restrictions which are present in numerous Member States⁹¹ increase the asymmetry between the tax treatment of profits, which are taxed immediately upon accrual, and the tax treatment of losses, which lead to refunds in the form of tax reductions only when offset against past or future profits. SMEs are, on average, more vulnerable to economic shocks and thus more likely to incur losses. They act in a smaller number of markets with a smaller number of products and services and thus their business risks are less diversified and their incomes more volatile. Hence, SMEs are more severely affected by the negative

⁸⁶ European Commission, 2003, *Commission Recommendation of 6 May 2003 concerning the definition of micro, small and medium-sized enterprises (2003/361/EC)*, Official Journal of the European Union, 2003 (L 124), pp. 36–41. Micro/small/medium: employees <10/50/250, turnover < € 2 Mio/10 Mio/50 Mio, total assets < 2 Mio/10 Mio/43 Mio. According to this SME definition, enterprises need to meet the employment threshold and either the turnover threshold or the maximum balance sheet total to be assigned to the respective size category.

⁸⁷ Eichfelder, S., 2010, *Folgekosten der Besteuerung aus entscheidungstheoretischer Perspektive*, Nürnberg: Datev, p. 20 et seq.

⁸⁸ Bergner, S.M., 2017, *Tax Incentives for Small and Medium-Sized Enterprises – A Misguided Policy Approach?*, Mannheim (Dissertation), p.126. Eichfelder, S., 2010, pp. 59-60. Sandford, C. T., et al., 1989, *Administrative and Compliance Costs of Taxation*, Bath: Fiscal Publications.

⁸⁹ European Commission, Directorate-General for Internal Market, Industry, Entrepreneurship and SMEs, European Innovation Council and SMEs Executive Agency, Di Legge, A., Ceccanti, D., Hortal Foronda, F., et al., 2022, p. 134.

⁹⁰ Bergner, S.M., 2017, p. 111 et seq.

⁹¹ See Endres, D., Spengel, C., 2015, p. 98.

consequences from restricted loss offsets than their larger competitors.⁹² This finding is particularly true for start-ups and young, high-risk ventures that are prone to incur start-up losses.⁹³

Furthermore, due to their smaller scale and limited international presence, SMEs have less opportunities than large companies to engage in international tax planning. Thus, they have considerably lower or even absent capabilities to shift profits to low-tax jurisdictions. A balanced view, however, includes taking into account the fact that smaller companies also have opportunities for tax planning that generally do not play an equally important role for large enterprises.

Small businesses, for example, can quite flexibly choose their legal form in a tax-optimal way.⁹⁴ Moreover, controlling owners of SMEs can optimize profit distributions according to their personal needs and preferences. In addition, profits can be extracted with the help of contracts between the company and the owners (e.g., employment contracts and shareholder loans). Altogether it is thus not clear, if and how much SMEs are really disadvantaged with regard to tax planning opportunities.⁹⁵

When implementing tax relief or support measures for SMEs, it is important to weigh up the already mentioned balanced consideration of actual disadvantages of small enterprises vis-à-vis larger firms with the possible negative consequences of regulations specifically targeted at supporting SMEs. Negative consequences of relief or incentive measures specifically aimed at SMEs arise in particular from the fragmentation of tax law that they inevitably entail. Such fragmentation leads to efficiency losses in the form of rising administrative costs and new distortions that influence action, e.g. the incentive not to grow beyond certain legally relevant size thresholds.⁹⁶

From a tax policy perspective, the following considerations are therefore helpful and recommendable: SMEs can best be relieved without further fragmentation of tax law by improving regulations or conditions from which they suffer to a particular degree, e.g. high tax complexity or restrictions on loss deduction, for all companies. A general reduction of tax complexity as well as a general improvement of loss offset regulations - without the need for further fragmentation - will benefit small and medium-sized enterprises in particular. Furthermore, any tax incentives should not be size-dependent, but should be geared to the economic activity to be promoted, e.g. research and development.⁹⁷

3.7. Spotlight II: retail investors

From the point of view of the Capital Markets Union, inefficient withholding tax procedures are one of the main barriers to the free movement of capital and capital market integration. This tax-related barrier reinforces potentially inherent capital market inefficiencies and stands in stark contrast with the economic principles and aims of the Union.

It has long been recognised that both institutional and private investors benefit from the geographical diversification of their investments.⁹⁸ The advantage from the associated risk diversification is all the

⁹² Bergner, S.M., 2017, pp. 111-112.

⁹³ Bührle, T., Spengel, C., 2020, *Tax Law and the Transfer of Losses: A European Overview and Categorization*, Intertax, Vol. 48, pp. 564-581. Bührle, T., 2021, *Do Tax Loss Restrictions Distort Venture Capital Funding of Start-Ups?*, ZEW Discussion Paper No. 21-008, Mannheim.

⁹⁴ De Mooij, R. A., Ederveen, S., 2008, *Corporate Tax Elasticities: A Reader's Guide to Empirical Findings*, Oxford Review of Economic Policy, Vol. 24, p. 682. Bergner, S.M., Heckemeyer, J. H., 2017, *Simplified Tax Accounting and the Choice of Legal Form*, *European Accounting Review*, Vol. 26, pp. 581-601.

⁹⁵ Bergner, S.M., 2017, p. 125.

⁹⁶ Ibid., p. 130 et seq.

⁹⁷ Ibid. Size-dependent relief can only be justified, if at all, in a narrowly defined area of administrative relief, e.g. in the form of greatly simplified accounting, where the disproportionate correlation between effective burden and company size is undeniable.

⁹⁸ Chan, K., et al., 2005, *What Determines the Domestic Bias and Foreign Bias? Evidence from Mutual Fund Equity Allocations Worldwide*, *Journal of Finance*, Vol. 60, p. 1495, with numerous further references.

greater, the lower the correlation of returns in different capital markets.⁹⁹ However, it has been shown that investors do not make efficient use of the opportunities for geographical diversification that are actually available to them in view of their access to diverse capital markets worldwide; instead, they are invested to an exaggerated extent in their respective home markets. The factors used to explain this phenomenon, which has become known as the "home bias", are partly institutional in nature and partly related to investor behaviour.¹⁰⁰ A relatively established explanatory factor is the concept of familiarity, meaning that investors may not evaluate the risk of different investments based on their past standard deviation of returns but impute an "extra risk" to foreign investments because they know less about foreign markets, institutions, and firms. Tax factors, however, are - in principle - considered to be of relatively little importance. After all, withholding taxes on investment income are regularly credited against the corresponding tax liability of the private investor in his country of residence. As long as investors have sufficient domestic tax liability against which to claim the credit for foreign withholding taxes, they do not face a definite burden from those foreign withholding taxes.¹⁰¹ A definitive, financially burdensome effect of foreign withholding taxes and thus their influence on the geographical allocation of capital market investments is, in principle, only conceivable if the withholding tax abroad exceeds the tax due on the capital income in the investor's country of residence. In principle, this should rarely be the case, especially if the investor's country of residence and the source country have agreed on a bilateral double taxation treaty. Accordingly, the withholding tax rates on dividends are regularly a maximum of 15 percent and those on interest, if they are not already exempt from withholding tax under unilateral law, a maximum of 10 percent (Art. 10 and 11 OECD-model). However, the countries levying withholding taxes do not retain the taxes reduced according to DTTs, but instead of such a relief at source, generally first deduct their (higher) national withholding tax rates from the respective income.¹⁰² The investor can then apply for a refund of the excess tax paid. However, non-resident portfolio investors' rights to a lower treaty rate are not always fully ensured by current functioning of withholding refund/relief procedures throughout the EU. In some countries more than in others, these refund procedures have proved to be lengthy, resource-intensive and costly for both investors and tax administrations (also see Chapter 3.3). As a consequence, non-resident portfolio investors may not exercise their right to apply for the reduced withholding tax rates given the inadequately high compliance costs or time delays. This is especially problematic because a tax credit granted by the investor's residence country is reduced by any treaty reduction in source country taxation the investor would have been entitled to, no matter whether the tax reduction was actually applied for and granted. Eventually, the investor's investment income in such cases is subject to double taxation, making it less attractive to invest in foreign EU capital markets, thus potentially reinforcing home bias or geographical clustering of investments.

⁹⁹ French, K. R., Poterba, J. M., 1991, *Investor Diversification and International Equity Markets*, American Economic Review (AEA Papers and Proceedings), Vol. 81, p. 222 et seq.

¹⁰⁰ Ibid., p. 224 et seq. Chan, K., et al., 2005, p. 1498.

¹⁰¹ French, K. R., Poterba, J. M., 1991, p. 224.

¹⁰² Sometimes, a non-resident investor's right to a reduced withholding tax rate is laid down in unilateral rules already. For example, in France, non-resident investors can apply for a withholding tax rate of 12.8 percent - instead of the current 26.5 percent standard withholding tax rate - through a specific relief procedure. Further reductions might still be available under relevant tax treaties.

Table 6: Income tax implications of cross border portfolio investment

	Germany	Country A	Country B	Country C
Gross dividend	100	100	100	100
Foreign withholding tax rate (unilateral)	n/a	0%	20%	20%
Treaty tax rate	n/a	n/a	15%	15%
Investor applies for treaty tax rate	n/a	n/a	yes	no
German withholding tax rate (before foreign tax credit)	25%	25%	25%	25%
German withholding tax rate (after foreign tax credit)	25%	25% (25% - 0%)	10% (25% - 15%)	10% (25% - 15%)
Overall withholding tax burden	25%	25%	25%	30%
Net dividend	75	75	75	70

Source: Author's own elaboration.

Note: Stylized calculation from the point of view of a private German retail investor who invests either in the German securities market or in securities of country A, country B or country C. German solidarity surcharge is ignored.

Table 6 illustrates the problem using the stylised example of a German retail investor who can acquire shareholdings in companies via the stock exchange alternatively in his home market of Germany, in country A, country B or in country C. A gross dividend of 100 monetary units can be expected from each investment. In the case of an investment in the German company, this results in a net dividend of 75 after deduction of the German final withholding tax of 25%. A net dividend of 75 also remains in the case of an investment in a company in country A, as country A does not levy any withholding tax. Country B does levy a national withholding tax of 20%, but on application by the German investor a reduction to the DTT tax rate of 15% can easily be achieved. The 15% withholding tax is then credited against the capital gains tax in Germany, resulting in a net dividend of 75. Country C, however, presents difficulties. Like country B, country C initially levies a withholding tax of 20% under national law. The withholding tax rate according to the DTT with Germany is only 15%, but the refund procedure is so cost-intensive, cumbersome and lengthy that the German investor refrains from application. Nevertheless, the German tax authorities only grant a foreign tax credit that reflects the DTT withholding tax rate of 15%. This results in double taxation. The net dividend amounts to only 70 monetary units. Although all investments generate the same gross dividend before tax, the German investor will refrain from investing in country C for tax reasons.

4. POLICY RECOMMENDATIONS

4.1. Considering the wider context: EU in the global competition

When thinking about tax obstacles in the European Internal Market, the attractiveness of the EU in the global competition for capital and investment is always at stake also in a broader context.¹⁰³ This report has already pointed out several times that in the latest phase of EU secondary law anti-avoidance measures against international tax arrangements, the EU is relying on instruments which, from the point of view of the companies affected, have an exclusively onerous effect. In a global view, the EU occupies an outstanding position with this type of strategy and also with the high speed and meticulousness with which it implemented the results of the OECD BEPS project. In contrast, for example, US tax policy is characterised by a greater awareness of the realities of international tax competition. Thus, even the weakly developed US CFC rules were never a sign of American ignorance or lack of overview, but a deliberate support for US multinationals in international competition. Accordingly, elements of the most recent major US tax reform of 2018 were also shaped by the need for investor-friendly taxation. With a so-called FDI (foreign derived intangible income) regime, the US favoured excess returns generated abroad by American companies, which are attributed to the use of intellectual property, with an effective tax rate of only 13.1 per cent. Ultimately, this regime was reminiscent of an IP box, which is hardly in line with the Nexus requirements of the BEPS project (Action 5). Admittedly, the reform also contained elements that were onerous for multinational companies, and in some cases even protectionist. Overall, however, the reform at least pursued a "carrot and stick" approach, encouraging companies to place profits and intellectual property in the United States.¹⁰⁴ Against this background, the dynamics surrounding the new edition of the OECD BEPS project, BEPS 2.0, is also remarkable. While the EU Commission is pressing ahead with the implementation of the global minimum tax and has already presented a corresponding draft directive¹⁰⁵, there are still numerous questions surrounding the issue of the legal stability and binding nature of such a complex mechanism outside Europe.¹⁰⁶ It is already clear that even with the global minimum tax, the fundamental role of taxation in international location competition¹⁰⁷ is unlikely to become obsolete. On the one hand, this is due to the design of the global minimum tax itself. Since only excess returns after the deduction of a substance-based carve-out are levelled up to the minimum tax rate of 15%, tax competition for substance remains intact.¹⁰⁸ Moreover, the consideration of deferred taxes in determining the effective tax burden allows states to compete on favourable tax base regulations, especially accelerated tax depreciation on fixed assets. Even to the extent that the minimum tax applies, competition between locations is likely to shift to other tax fields, such as the taxation of highly qualified labour¹⁰⁹, or omitted tax advantages are potentially compensated for by subsidies. The latter route in particular, however, is barred to EU Member States against the background of EU state aid

¹⁰³ Hey, J., 2018, p. 22.

¹⁰⁴ Heckemeyer, J. H., *Wie Trumps Tax Cuts Europa unter Zugzwang setzen - Die US-Steuerreform 2018: Maßnahmen, Implikationen und erste empirische Befunde*, ifo-Schnelldienst, Vol. 73 (1), pp. 18-20.

¹⁰⁵ European Commission, 2021, *Proposal for a Council Directive on Ensuring a Global Minimum Level of Taxation for Multinational Groups in the Union*, COM(2021) 823 final.

¹⁰⁶ Schreiber, U., Spengel, C., 2021, *Die Steuerpläne der OECD: Ausweg oder Irrweg?*, *Der Betrieb* 2021, p. 2518 et seq.

¹⁰⁷ Fuest, C., Huber, B., 1999, *Steuern als Standortfaktor im internationalen Wettbewerb*, Köln: Dt. Inst.-Verl.

¹⁰⁸ Devereux, M., et al., 2022, *Pillar 2: Rule Order, Incentives, and Tax Competition*, Oxford University Centre for Business Taxation Policy Brief.

¹⁰⁹ Fischer, L., et al., 2022, *Tax Policies in a Transition to a Knowledge-Based Economy: The Effective Tax Burden of Companies and Highly Skilled Labour*, *Intertax*, Vol. 50, pp. 286-231.

law.¹¹⁰ This, in turn, puts the EU in a potentially disadvantageous position compared to more flexible locations such as the USA or Great Britain after the BREXIT.

In addition, there are particularly ambitious EU requirements such as public country-by-country reporting, which even goes beyond the BEPS agreements and obliges companies with a turnover of more than € 750 million to provide comprehensive public information on the structure of their value chains, cost structures and profit margins. Competitive disadvantages for affected European corporations cannot be ruled out.¹¹¹

From a European perspective, alternatives to the measures planned in the course of BEPS 2.0 would therefore have been well worth considering. For years, there have been proposals for a reform of the taxation of royalties in the Internal Market, which could effectively counter tax planning with highly profitable IP through a (creditable) withholding tax on royalty flows.¹¹² The planned allocation of tax substrate to market countries in the course of Pillar 1 of BEPS 2.0 could also be achieved in a simpler way by reforming the value-added tax.¹¹³

4.2. Fundamental tax reform: a harmonised corporate income tax

Some of the fundamental tax obstacles and distortions in the Internal Market discussed in Chapter 3 can (only) be addressed by harmonisation of corporate taxation in the EU. Against this background, the concept of a Common Consolidated Corporate Tax Base (CCCTB) has been discussed for many years as a fundamental reform option. The EU Commission presented a first draft directive in 2011, revised it in the following years in view of open questions and political resistance, and then reintroduced the proposal for a C(C)CTB in 2016.¹¹⁴ The basic idea of the new approach was a step-by-step procedure, in which a Common Corporate Tax Base (CCTB) would first establish independent and uniform European regulations for a harmonised profit tax base. Only in a further stage is a consolidation of group profits with subsequent formula apportionment to the Member States envisaged. In 2021, the EU Commission confirmed the plan for a common corporate tax base within the EU, including its formula-based allocation, under the new label "Business in Europe: Framework for Income Taxation (BEFIT)". Relative to the previous C(C)CTB proposal, the BEFIT is supposed to reflect the recent significant changes in the economy and in the international tax framework – especially considering the OECD BEPS 2.0 project with its global minimum tax based on an internationally agreed tax base definition. However, in the EU Commission's plans to date, the introduction of a C(C)CTB is only envisaged for multinational groups with a consolidated turnover of more than € 750 million. Already the first stage of a common corporate tax base, i.e. the harmonisation of the profit determination rules, means a noticeable reduction in tax compliance costs for companies, which have so far resulted from dealing with multiple different tax systems in the Internal Market. In the long term, an average reduction in compliance costs of 2.5% can be assumed for the companies covered by the C(C)CTB.¹¹⁵ The reduction in tax compliance costs would be associated with greater economic efficiency.

¹¹⁰ Schreiber, U., Spengel, C., 2021, p. 2517.

¹¹¹ Evers, M. T., et al., 2017, *Country-by-Country Reporting: Tension Between Transparency and Tax Planning*. ZEW Discussion Papers 17-008, Mannheim, pp. 9-10.

¹¹² Fuest, C., et al., 2013, p. 319.

¹¹³ Spengel, C., et al., 2021, *EU sollte statt einer Digitalabgabe die indirekten Steuern stärker in den Blick nehmen*, ZEW policy brief Nr. 21-02, Mannheim.

¹¹⁴ European Commission, 2011, *Proposal for a Council Directive on a Common Consolidated Corporate Tax Base (CCCTB)*, COM(2011) 121 final. European Commission, 2016, *Proposal for a Council Directive on a Common Corporate Tax Base*, COM(2016) 685 final. European Commission, 2016, *Proposal for a Council Directive on a Common Consolidated Corporate Tax Base (CCCTB)*, COM(2016) 683 final.

¹¹⁵ European Commission, 2016, *Impact Assessment: Proposals for a Council Directive on a Common Corporate Tax Base and a Common Consolidated Corporate Tax Base (CCCTB)*, SWD(2016) 341 final, Annex VII, p. 136.

Member States with the lowest compliance costs before the reform and those that have large inward foreign investment stock would benefit more than other Member States. Cross border business operations would particularly benefit¹¹⁶. In conjunction with the harmonisation of the determination of taxable profits, a CCTB promises further important advantages in the taxation of cross border situations. Within the framework of a Europe-wide uniform corporate tax base, the emergence of qualification conflicts in the Internal Market would already be prevented, since the uniform profit determination rules would also regulate the tax treatment of shareholder distributions, the demarcation between equity and debt capital in hybrid financing instruments and the deduction of financing costs. A uniform tax base would also cover consistent rules on loss determination, which would be an important prerequisite for the further development of group taxation towards cross border loss offsetting.¹¹⁷

If, in addition, multinational group profits are consolidated according to the model of the C(C)CTB, which includes a consolidation of capital, receivables and debts as well as an elimination of intercompany profits, the basis for taxation is the (apportionable) net result of the group. The use of a net group result leads to further significant advantages: By consolidating the income at the level of the group parent company, all intra-group transactions would be eliminated from the taxable income, so that international profit allocation through transfer pricing is no longer necessary and profit shifting by means of inappropriate transfer prices is no longer possible. This also eliminates the need for transfer pricing-related documentation requirements in the Single Market, which can be expected to reduce group-wide compliance costs by more than 60%.¹¹⁸ Since with formula apportionment of profits there is no longer any incentive or starting point for cross border book profit shifting in the Single Market, in the case of a C(C)CTB there would also no longer be any need for interest deduction restrictions and CFC regulations. By splitting the net result, all Member States in which group members are domiciled participate proportionately in the group's expenses. Thus, in particular, financing expenses of the group would be distributed to all Member States in which group companies are domiciled. In the case of cross border restructuring or asset transfers, hidden reserves would not have to be taxed directly, but would, upon realization, be allocated proportionately to the group companies on the basis of the distribution key and taxed there.¹¹⁹

The CCTB and, in the extension, above all the C(C)CTB also facilitate the cross border offsetting of losses within European groups, which has not been consistently achieved in the Internal Market so far. A uniform basis of assessment throughout Europe first of all ensures a uniform determination of (foreign) losses. In the case of a consolidation of profits, there is also a direct comprehensive offsetting of losses within the group. Thus, losses of the parent company are also offset against profits of subsidiaries as well as profits and losses of sister companies. Since the loss is only determined once throughout the group, double or even multiple loss utilisation is prevented. Through the allocation of the net result, all Member States in which group members are domiciled participate proportionately in the losses of the group. This would remove the motivation for tax planning efforts aiming to deduct losses primarily in high-tax countries.

¹¹⁶ Barrios, S., et al., 2020, *Reducing Tax Compliance Costs Through Corporate Tax Base Harmonization in the European Union*, Journal of International Accounting, Auditing and Taxation, Vol. 41, 100355.

¹¹⁷ Spengel, C., Stutzenberger, K., 2018, p. 39.

¹¹⁸ European Commission, 2016, p. 136.

¹¹⁹ Spengel, C., Stutzenberger, K., 2018, p. 40.

If the concept of group taxation including consolidation and formulaic profit allocation (CCCTB) is not implemented immediately, cross border loss relief can also be made possible at an earlier stage of harmonisation, accompanied by a special form of the recapture method.

The CCTB draft directive as of 2016 provided for a regulation that was comparable to the proposal for a Council directive on cross border loss relief already submitted in 1990.¹²⁰ The recapture method ensures that the deducted loss is offset again by an ex post adjustment as soon as profits arise again in subsequent years at the level of the loss-making EU group entity. Double loss utilisation is thus excluded.¹²¹

While a cross border loss offset certainly raises questions in terms of revenue implications and budget balancing between Member States, cross border loss offset would be a very strong signal for the competitiveness and attractiveness of the Single Market and could even be welfare enhancing.¹²²

The benefits of the C(C)CTB summarised in Table 7 make it clear that the basic idea of a C(C)CTB is much more comprehensive and far-reaching than the previous symptom-based measures under the OECD-BEPS project and its implementation in the EU through the ATAD and adjustments to the DAC. In particular, unlike these previous measures, a C(C)CTB would bring companies tangible benefits.

Table 7: Reduction of tax obstacles in the Internal Market through a C(C)CTB

Reduction of tax obstacles with regard to	Common corporate tax base (CCTB)	Common corporate tax base including cross border loss offset	Common consolidated corporate tax base (CCCTB)
Compliance costs	Yes	Yes	Yes
Cross border loss offset	No	Yes, vertical	Yes, group-wide
Financing	No, unless national regulations already provide for this	No	Yes, interest deduction restrictions and CFC rules are redundant; group-wide allocation of financing costs
Relocation, reorganisations, deliveries	No	No	Yes, through consolidation
Transfer prices	No, transfer prices are still needed for international profit allocation	No	Yes, replaced by formula
Double taxation due to colliding taxation rights	No	No	Yes

Source: Spengel, C., Stutzenberger, K., 2018, Widersprüche zwischen Anti-Tax Avoidance Directive (ATAD), länderbezogenem Berichtswesen (CbCR) und Wiederaufnahme einer Gemeinsamen (Konsolidierten) Körperschaftsteuer-Bemessungsgrundlage (GK(K)B), IStR, Vol. 27, p. 39.

¹²⁰ European Commission, 1991, *Proposal for a Council Directive Concerning Arrangements for the Taking into Account by Enterprises of the Losses of Their Permanent Establishments and Subsidiaries Situated in other Member States*, COM(90) 595 final.

¹²¹ Scheffler, W., Köstler, M., 2017, *Richtlinie über eine Gemeinsame Körperschaftsteuer-Bemessungsgrundlage – mehr als eine Harmonisierung der steuerlichen Gewinnermittlung*, ifst-Schrift 518, p. 106 et seq. The draft CCTB guidelines also provided for a recapture of losses after the expiry of five years even if no profits had accrued in the meantime at the foreign entity (Art. 42 (3) (a) CCTB-draft). This in turn would mean that in the case of permanent (final) losses abroad, no final loss offset is possible.

¹²² Hey, J., 2006, p. 120. Runkel, M., Kalamov, Z., 2016, *On the Implications of Introducing Cross-Border Loss-Offset in the European Union*, Journal of Public Economics, Vol. 144, pp. 78-89.

Conversely, both the ATAD regulations and the CbCR would become superfluous if a CCCTB were introduced, because they address symptoms of problems that would be solved from scratch under the CCCTB.

If the existing directives were nevertheless maintained and the CCCTB were introduced for companies with a consolidated turnover above €750 million, this would result in a coexistence of regulatory regimes. For multinational companies with a turnover below the critical threshold, only the ATAD would continue to apply; for companies above this threshold, the minimum standards of the ATAD would apply with regard to the matters covered therein (interest deduction limitation, CFC rules, anti-hybrid rules) and, in parallel and at the same time, the uniform tax base rules of the CCTB.¹²³ The consequence of this coexistence would be new legal uncertainties and tax planning opportunities.¹²⁴ Similarly, the continuation of the obligation for country-by-country reporting for companies above the turnover threshold of €750 million would result in an unnecessary duplication of documentation and transparency requirements. Finally, under a C(C)CTB, the harmonisation of the corporate tax base would already increase the transparency of the tax competition, which would henceforth be conducted mainly via statutory tax rates. In addition, any formula apportionment would lead to the recording and disclosure of the formula factors anyway. An additional costly reporting obligation vis-à-vis the tax authorities within the framework of the CbCR could thus become superfluous. In view of the exclusively burdensome effects of the ATAD or the CbCR from a corporate perspective and the potential overlap with the C(C)CTB, it seems worth considering extending the scope of application at least of the harmonisation of the tax base to all companies subject to corporate income tax and, in return, withdrawing the ATAD or also the obligation to the CbCR in the Internal Market.¹²⁵

4.3. Reduce compliance costs and double taxation risk through more efficient legislation, administration, and proceedings

In its communication on “Business Taxation for the 21st Century” in May 2021¹²⁶, the European Commission proposes a debt equity bias reduction allowance (DEBRA) to address the tax-induced distortions of debt financing. The aim is to temper the current beneficial tax treatment of debt financing in the corporate income tax systems of the Member States (“debt bias”) resulting from the fact that, in the case of debt-financed investments, interest costs are deductible for tax purposes, whereas there is no equivalent relief in the case of equity-financed investments.

For a legislative proposal, the European Commission identified three possible concepts: First, a Comprehensive Business Income Tax (CBIT) that disallows the tax-deductibility of any financing cost. Second, an Allowance for Corporate Equity (ACE) that provides for the deductibility of notional interest on either all equity or new equity. Third, an alignment of the treatment of debt and equity financing by deducting a notional return on all capital, namely an Allowance for Corporate Capital (ACC).¹²⁷

Given the diverse negative macroeconomic effects associated with the debt bias, the high attention paid to this problem within the European Commission can be appreciated. However, addressing the

¹²³ Scheffler, W., Köstler, M., 2017, pp. 114-115.

¹²⁴ Spengel, C., Stutzenberger, K., 2018, p. 43.

¹²⁵ Ibid., pp. 42-43.

¹²⁶ European Commission, 2021, *Business Taxation for the 21st Century*, COM(2021) 251 final.

¹²⁷ The 2016 CCTB draft directive already contained a proposal for an incremental variant of the ACE under the name Allowance for Growth and Investment (AGI). For a detailed evaluation of the three alternative concepts, especially in the context of a C(C)CTB, see Spengel, C., et al., 2018, *Addressing the Debt-Equity Bias within a Common Consolidated Corporate Tax Base (CCCTB) – Possibilities, Impact on Effective Tax Rates and Revenue Neutrality*, World Tax Journal, Vol. 10, pp. 165-191.

debt bias at EU-level does not seem advisable. In order not to induce massive distortions of legal form and financing decisions through inconsistencies in the national taxation systems, the respective adjustments - such as an interest adjustment under an ACE regime - would have to be made not only for corporate income tax, but also consistently for personal income tax purposes.

The European Commission has so far ruled out a harmonisation of personal income taxation and assigned this right exclusively to the Member States. The fact that the individual Member States are indeed independently capable of integrating instruments to avoid equity discrimination into their national taxation systems can be seen in countries such as Belgium and Italy, which have implemented variants of an ACE, or - outside the EU - in Norway, whose tax system essentially follows the concept of a dual income tax. Taking into account the principle of subsidiarity according to Article 5 (3) of the Treaty on European Union, addressing debt bias at EU level should therefore be rejected and left to the Member States.¹²⁸ A very similar conclusion also applies to the EU Commission's plan for an EU-wide uniform super-deduction of business expenses to promote research and development in the context of the previous C(C)CTB draft directives from 2016. The individual Member States are in a position to integrate their own tax measures to foster R&D into their taxation systems.¹²⁹

Instead of focusing on these latter aspects, which on the one hand do not represent significant obstacles to cross border business activity from an Internal Market perspective and on the other hand can be better addressed by the Member States themselves, the EU's immediate focus should be on the reduction of actual tax obstacles in the Internal Market. The discussion in Chapter 3.3 has demonstrated that the tax policy agenda of recent years has resulted in a marked rise in tax compliance costs as well as tax complexity. Given the further measures planned under BEPS 2.0, in particular the introduction of a global minimum tax, this trend remains unbroken for all companies concerned. The directives issued in this phase of strengthening anti-avoidance and tax transparency were and are, with the exception of the Dispute Settlement Directive, exclusively burdensome for the affected companies. The focus of the EU should therefore be on decisively counteracting this dynamic of the increase in tax compliance costs.

Initiatives already launched by the EU and the OECD to reduce tax compliance costs for taxpayers are therefore to be welcomed and expanded.¹³⁰ This applies first of all to the current initiative of the EU Commission "New EU system for the avoidance of double taxation and prevention of tax abuse in the field of withholding taxes"¹³¹ that aims to build on the OECD treaty relief and compliance enhancement

¹²⁸ Spengel, C., et al., 2021, *Debt-Equity Bias Should Be Addressed on National Rather Than on EU Level*, ZEW policy brief No. 21-07, Mannheim. Spengel, C., et al., 2008, *Reforming Income and Company Taxation by the Dual Income Tax*, ZEW Economic Studies 39, Heidelberg. The dual income tax can be considered as an effective measure to address debt bias on a national level. Under this concept, business income is taxed at the corporate level, and any interest payments are deductible. At the personal income level, labour income is subject to progressive income taxation while a flat tax rate, equal to the corporate tax rate, is applied on capital income. Profit distributions that have already been subject to corporate tax and do not exceed a predefined standard rate of return are tax-exempt at the personal level. Distributions exceeding the standard rate of return shall be taxed at a flat tax rate leading to an overall tax burden similar to the progressive income tax rate. Such a dual income tax system establishes not only financing neutrality but also neutrality concerning profit distributions and legal forms. Consequently, a dual income tax system is well suited to fulfil the objectives stated by the European Commission.

¹²⁹ Spengel, C., Stutzenberger, K., 2018, p. 43. With the exception of Bulgaria, Estonia, Latvia and Cyprus, all EU countries already have such R&D tax incentives in place. OECD, 2021, *OECD Compendium of Information on R&D Tax Incentives*, <http://oe.cd/rdntax>, retrieved on 13/05/22.

¹³⁰ European Commission, 2020, *An Action Plan for Fair and Simple Taxation Supporting the Recovery Strategy*, COM(2020) 312 final. European Commission, 2020, *A Capital Markets Union for People and Businesses - New Action Plan*, COM(2020) 590 final.

¹³¹ European Commission, 2021, *New EU System for the Avoidance of Double Taxation and Prevention of Tax Abuse in the Field of Withholding Taxes*, Ref. Ares(2021)5900310.

(TRACE) project¹³² and former initiatives in that context, like the EU Code of Conduct on withholding tax.¹³³ The initiative has the objective to facilitate and harmonise withholding tax relief procedures (documentation requirements, forms and timing of procedures) for non-resident portfolio investors while at the same time protecting against tax abuse. Whether the TRACE programme developed by the OECD can be a useful starting point, however, seems to be judged very critically by the EU Member States for the most part. So far, Finland is the only EU country to have introduced the TRACE procedure for dividend payments to limited taxpayers (on a voluntary basis) since 2021. Meanwhile, Germany, in its most recent revision of the procedure for withholding taxation, expressly decided against following TRACE, citing fears of abuse.¹³⁴ At present, the EU Commission's initiative is aimed in particular at simplifying the procedure of withholding tax collection for portfolio investors. However, it is imperative that the taxation procedure is also simplified for direct investors. Withholding tax exemptions under the EU directives or the procedures for the tax-neutral return of capital contributions are also not harmonised, long-term and cost-intensive and therefore have a comparable negative impact on investment activity (see Chapter 3.3).

The EU must promote harmonised and efficient taxation procedures and the reduction of legal uncertainty in other areas as well. Against this background, it seems fundamentally positive that in the course of DAC 7, a legal framework was also created for conducting joint audits between two or more Member States as of 1.1.2024.¹³⁵ Joint audits serve to avoid tax disputes regarding the tax circumstances or cross border business relationships of companies. Through the bilateral and multilateral external audits, preventive and unbureaucratic solutions are possible at an early stage, which offers considerable advantages from the taxpayer's perspective.¹³⁶ Joint audits are one aspect of the so-called OECD Tax Certainty Agenda, with the aim to improve legal certainty and application of tax law. Such efforts should be taken up and intensified. In the EU context, it also makes sense to accelerate infringement proceedings by improving the resources and staffing of the responsible bodies.

In order to avoid potential violations of EU fundamental freedoms and subsequent lengthy proceedings, a strong voluntary commitment by the Member States in the sense of a Code of Conduct to a speedy and foreseeable final implementation of European legal requirements could be an important step. In addition, an innovative idea would be for the EU states to agree, at least in principle, to give greater weight to the opening of the Internal Market in the future than has been the case to date in alternative ways of eliminating discrimination by adapting the law.

¹³² OECD Implementation Package from February 2012, https://www.oecd.org/ctp/exchange-of-tax-information/TRACE_Implementation_Package_Website.pdf. More detailed information: <https://www.oecd.org/ctp/exchange-of-tax-information/aboutthetracegroup.htm>. The TRACE programme provides for a withholding tax reduction directly upon payment of the investment income (relief at source) and thus avoids a lengthy refund procedure. A standardised self-disclosure by the investor, which is confirmed to the custodian bank by means of an identity card or extract from the commercial register, is intended to make a certificate of residence unnecessary.

¹³³ European Commission, 2017, *Code of Conduct on Withholding Tax*, https://ec.europa.eu/taxation_customs/system/files/2017-12/code_of_conduct_on_withholding_tax.pdf.

¹³⁴ Frey, M., Jung, M., 2019, *Bewegung bei der automatischen Abwicklung von Quellensteuererstattungen durch TRACE*, IStR, Vol. 28, pp. 924-929. Schurowski, S., 2021, *Das neue Verfahren zur Behandlung des Kapitalertragsteuerabzugs nach dem Abzugsteuerentlastungsmodernisierungsgesetz und die Abkehr vom OECD Model "TRACE" in Deutschland*, FinanzRundschau 5/2021, p. 213 et seq.

¹³⁵ Council Directive (EU) 2021/514 of 22 March 2021.

¹³⁶ Dölker, A., 2021, *Internationalisierung der Unternehmensbesteuerung in Deutschland: Herausforderung für Tax Compliance und Außenprüfung – Teil 1*, StB 2021, p. 259.

However, efforts to reduce tax complexity and the associated compliance costs are potentially counteracted by the planned further anti-avoidance measures in the course of BEPS 2.0, in particular the global minimum tax.

When designing the further tax measures that will be required if BEPS 2.0 is implemented, procedural issues and the threat of complexity due to interactions with existing anti-avoidance rules should be consistently considered and remedied in order to counteract a further drastic increase in administrative and tax compliance costs as well as the further emergence of double taxation risks.

Furthermore, at the latest with the implementation of BEPS 2.0, all plans for the implementation of a digital levy on the part of the EU Commission should be finally abandoned and existing unilateral digital levies in the EU Member States should be withdrawn.

5. CONCLUSIONS

This report documents that, in the past, EU Member States have found it much easier to agree on curbing international tax planning than on reducing tax and administrative barriers in the Single Market. As a consequence, tax distortions in real investment decisions in the Single Market have never decreased but increased over the past 20 years, the highly relevant barrier of an impossible cross border loss offset has not been resolved at all, whereas leeway for international tax planning has actually decreased, but at the cost of a complexity explosion.

Going forward, the EU must position itself in the global competition. The US tax policy has long been characterised by a greater awareness of the realities of international tax competition, providing also carrots and not only the stick for investors. In contrast, the EU stands out globally with a high-speed strategy that almost exclusively centers on the fight against tax avoidance. The Anti-Tax Avoidance Directive is representative for this endeavour: It is the first EU directive that does not bring any tax advantages for affected taxpayers, but only entails restrictions and costs. The EU Commission keeps on pressing ahead with the implementation of the projected global minimum tax. However, it is already clear that even with the global minimum tax, the fundamental role of taxation in international location competition is unlikely to become obsolete. On the one hand, this is due to the design of the global minimum tax itself. On the other hand, competition between locations is likely to shift to other tax fields, such as the taxation of highly qualified labour or omitted tax advantages are potentially compensated for by subsidies. The latter route in particular, however, is barred to EU Member States against the background of EU state aid law. This, in turn, puts the EU in a potentially disadvantageous position compared to locations that are more flexible.

Some of the fundamental tax obstacles and distortions in the Internal Market can (only) be addressed by a substantial harmonisation of corporate taxation in the EU. The idea is to establish independent and uniform European regulations for a harmonised profit tax base and then to consolidate group profits with subsequent formula apportionment to the Member States. In 2021, the EU Commission reconfirmed this plan under the new label "Business in Europe: Framework for Income Taxation (BEFIT)". Within the framework of a Europe-wide uniform corporate tax base, the emergence of qualification conflicts in the Internal Market would be prevented, since the uniform profit determination rules would also regulate the tax treatment of shareholder distributions, the demarcation between equity and debt capital in hybrid financing instruments and the deduction of financing costs. A uniform tax base would also cover consistent rules on loss determination, which would be an important prerequisite for the further development of group taxation towards cross border loss offsetting.

If the concept of group taxation including consolidation and formulaic profit allocation is not implemented immediately, cross border loss relief could be made possible at an earlier stage of harmonisation. While this certainly would raise questions in terms of revenue implications and budget balancing between Member States, cross border loss offset would be a very strong signal for the competitiveness and attractiveness of the Single Market.

Since formula apportionment annihilates any incentive or starting point for cross border profit shifting in the Single Market, there would no longer be any need for highly complex anti-avoidance measures in the Single Market. In view of the burdensome effects of the ATAD, it seems worth considering extending the scope of application at least of the harmonisation of the tax base to all companies subject to corporate income tax and, in return, withdrawing the ATAD in the Internal Market.

The EU's immediate focus should be on the reduction of actual tax obstacles in the Internal Market. Initiatives already launched by the EU and the OECD to reduce tax compliance costs for taxpayers are therefore to be welcomed and expanded. Besides the urgent need to simplify the relief or refund procedures for withholding taxes in the Single Market, the EU must generally promote harmonised and efficient taxation procedures and the reduction of legal uncertainty in other areas as well. Against this background, it seems fundamentally positive that in the course of DAC 7, a legal framework was also created for conducting joint audits between two or more Member States as of 1.1.2024. Joint audits are one aspect of the so-called OECD Tax Certainty Agenda, with the aim to improve legal certainty and application of tax law. Such efforts should be taken up and intensified. In the EU context, it also makes sense to accelerate infringement proceedings by improving the resources and staffing of the responsible bodies.

In order to avoid potential violations of EU fundamental freedoms and subsequent lengthy proceedings, a strong voluntary commitment by the Member States in the sense of a Code of Conduct to a speedy and foreseeable final implementation of European legal requirements could be an important step. In addition, an innovative idea would be for the EU states to agree, at least in principle, to give greater weight to the opening of the Internal Market in the future than has been the case to date in alternative ways of eliminating discrimination by adapting the law.

However, efforts to reduce tax complexity and the associated compliance costs are potentially counteracted by the planned further anti-avoidance measures in the course of BEPS 2.0, in particular the global minimum tax. When designing the further tax measures that will be required if BEPS 2.0 is implemented, procedural issues and the threat of complexity due to interactions with existing anti-avoidance rules should be consistently considered and remedied in order to counteract a further drastic increase in administrative and tax compliance costs as well as the further emergence of double taxation risks. Furthermore, at the latest with the implementation of BEPS 2.0, all plans for the implementation of a digital levy on the part of the EU Commission should be finally abandoned and existing unilateral digital levies in the EU Member States should be withdrawn.

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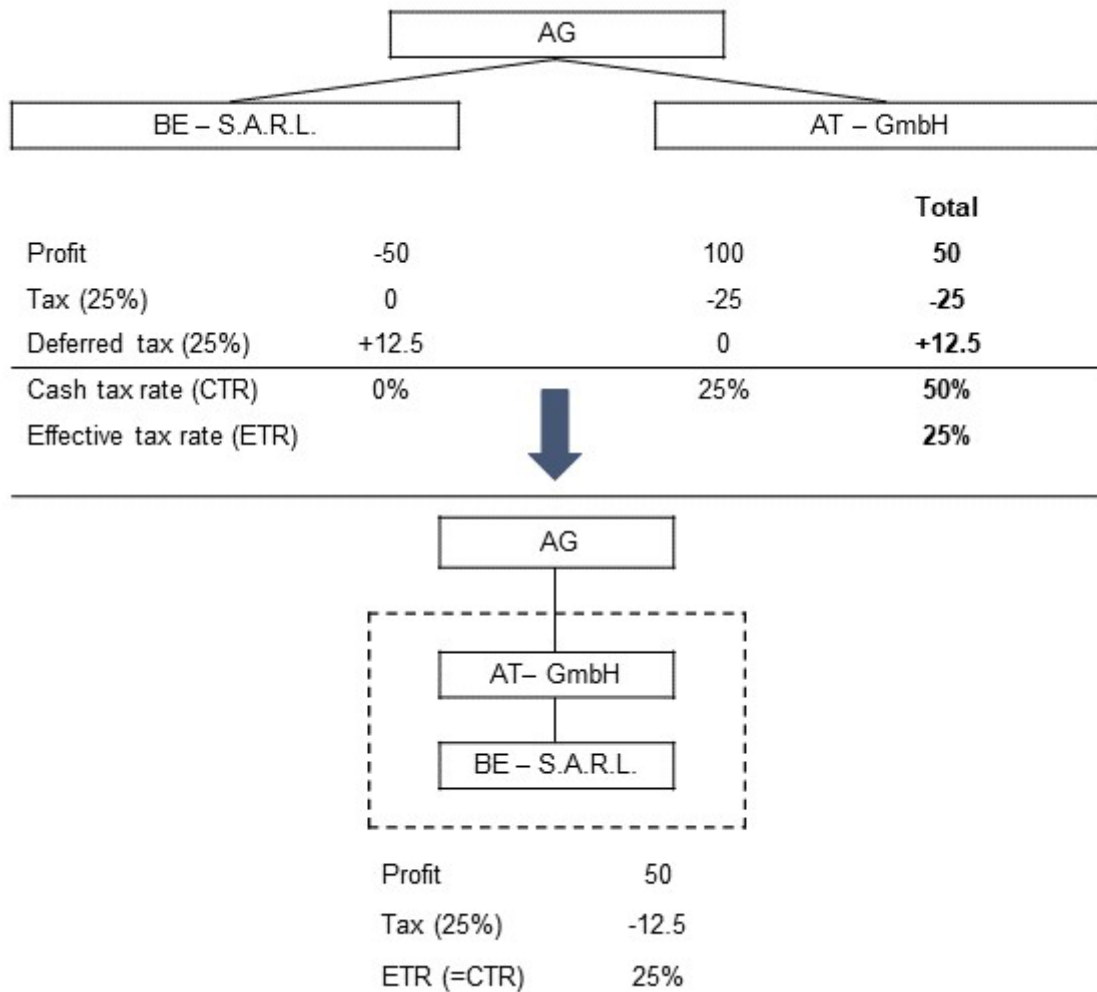
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ANNEX

Figure A-1: Cross border loss compensation under a holding



Source: Endres, D., Spengel, C., 2015, International Company Taxation and Tax Planning, Alphen aan Den Rijn: Kluwer Law International, p. 485.

The coexistence of 27 different national tax systems in the European Union brings about significant obstacles to cross border business activity in the European Single Market. The objective of this study is to show the context and developments in European secondary law that have led to the current situation or, at least, have not yet resolved it. In addition, perspectives are shown as to how the described obstacles to cross border investment in the Internal Market can be countered both in the short and long term, both at the fundamental and also at the procedural or administrative level.

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