Unitary Taxation: Tax Base and the Role of Accounting

Prem Sikka

Essex Business School

Richard Murphy

Tax Research LLP, Date Written: April 21, 2015

Abstract

For more than twenty years there have been discussions on the issue of multinational corporations shifting profits from high- to low-tax jurisdictions, with resulting gains to them from the resulting reduction in their effective tax rate. Underpinning much of this debate has been an implicit assumption that, first of all, profits are a fixed and constant known factor in this tax base-shifting equation; and, secondly, that by adopting consistent international financial reporting standards (IFRSs) the risk of arbitraging on tax is removed from this equation. Arguments for unitary taxation have particularly advanced this assumption.

We seek to show that the relationship between tax and financial reporting is now remote, and that no jurisdiction that we can identify relies upon unadjusted traditional accounting profit as a basis for the taxation of corporate income. This paper argues that this problem would, if anything, increase with dependence upon IFRSs, which serve entirely different purposes. IFRSs contain many subjective elements within their concepts of income and expenses, to provide the certainty that tax reporting requires. We draw instead upon the thinking underpinning the European Union's (EU's) Common Consolidated Corporate Tax Base (CCCTB), to suggest that tax-specific measures of income and expenses for taxation purposes need to be defined. Such a transactional approach provides a potential basis for developing unitary taxation and determining a taxation base that could then be apportioned to each jurisdiction. However, in the practical political context the EU needs to be sensitive to the interests of member states, which have an interest in adopting particular ways of dealing with deductibility of interest, royalty payments and allowances for capital expenditure. In order to secure political momentum for change, we suggest that for the time being such contentious matters be deferred by allowing relief on these items to be granted at a national level after apportionment of other income between participating states in a regional unitary tax system. The paper then makes some suggestions for the development of a conceptual framework for taxation accounting standards that could be used to address these issues.

Keywords: tax avoidance; accounting; transfer pricing; accounting standards; unitary taxation

Sikka, Prem and Murphy, Richard, Unitary Taxation: Tax Base and the Role of Accounting (April 21, 2015). Available at SSRN: https://ssrn.com/abstract=2633997 or http://dx.doi.org/10.2139/ssrn.2633997