

Destination based taxation of corporate profits – preliminary findings regarding tax collection in cross-border situations

July 2017

WP 17/16

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Working paper series | 2017

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DESTINATION BASED TAXATION OF CORPORATE PROFITS - PRELIMINARY FINDINGS REGARDING TAX COLLECTION IN CROSS-BORDER SITUATIONS

by Marie Lamensch¹

Abstract

There is currently a strong movement in the academic discussion of direct taxation to shift corporation income taxes to a destination based system where the taxing rights would be allocated on the basis of the place of sales. Two major advantages of such a shift would include the removal of current complexities in corporate income tax systems and the curbing of tax base erosion and profit shifting opportunities for multinationals. Among the leading articles on the topic, only one of them develops on the issue of tax collection. In this paper the author suggests that this “implementation issue” is more than a detail because existing collection schemes will not do the job.

1. Introduction

Corporate income tax (hereafter “CIT”) revenue have been under huge pressure in recent years. Estimates indicate that the global CIT revenue losses could be between 4% to 10% of global CIT revenues, i.e. USD 100 to 240 billion annually.² The losses arise from a variety of causes, including aggressive tax planning by some multinationals, the interaction of domestic tax rules, the lack of transparency and coordination between tax administrations, the limited country enforcement resources and harmful tax practices. These causes themselves are largely the result of international tax rules designed in the mid-1950s that have become outdated and/or vulnerable to aggressive tax planning in an increasingly global and digital economy.³

Against this background, on the policy side the G20 prompted the OECD to launch an action plan with a view to tackle so-called “base erosion and profit shifting” (hereafter “BEPS”) in 2013. Fifteen actions were identified and reports for each of them have now been released that seek to propose new or reinforced international standards, as well as concrete measures to help countries tackle BEPS. One of the guiding principles of the BEPS project is the willingness to reconcile value creation and taxation.⁴ In this context, the idea that States should be able to tax corporate income generated from sales made in their territory is making its way.

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² OECD/G20 (2015): Base Erosion and Profit Shifting Project – Explanatory Statement, p. 4. Available at: <http://www.oecd.org/ctp/beps-explanatory-statement-2015.pdf>

³ M. Devereux, R. de la Feria (2014): Designing and Implementing a Destination-Bases Corporate Tax”, Oxford University Centre for Business Taxation Working Paper 14/07, p. 1. In a nutshell, the increasing importance of intellectual property (IP) in MNEs’ valuations, the decreasing relevance between production and sales locations and the fact that it is less and less clear where value creation takes place result in source and residence-based tax systems failing to keep up (H. Liebman, “what does US Tax reform mean for global business taxation”, Accountancy Europe 2017 Tax Day, 30 May 2017).

⁴ See for example the proposed amendments in the area of transfer pricing (BEPS Action 8-10).

At the moment the exact outcome of the BEPS project is uncertain, although the EU Member States have proactively started implementing some targeted anti-BEPS measures⁵ and the signature of the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting (so-called “MLI”) on 7 June 2017 is a most promising development.⁶ However, a major change such as a shift of corporate profits’ place of taxation does not seem likely to happen in the near future.⁷

On the academic side, the proposal for a destination based type of taxation of corporate profit in the form of a cash flow tax (hereafter “DBCFT”) already appeared in the economic literature in the early 2000s and continues being studied.⁸ Building on this work, the US Ways and Means Committee released a Blueprint for future tax reforms in June 2016 (hereafter “Ryan Blueprint”) that includes a flagship reform aimed at turning the US CIT system into a form of DBCFT.⁹ This proposal has already been commented in the literature¹⁰ and gives a new boost to the academic work on DBCFT. To be noted, however, that recent communication by the US Administration seems to suggest that a slightly different reform proposal than proposed under the Ryan Blueprint might eventually land on the table of the US Senate.¹¹

After a brief overview of the basic features and legal critiques that can be formulated against a DBCFT, the objective of this paper is to offer an in-depth discussion of the question how to collect such tax

⁵ See for example the amended provisions of the Parent-Subsidiary Directive (pursuant to the adoption of Council Directive (EU) 2015/121 of 27 January 2015 amending Directive 2011/96/EU on the common system of taxation applicable in the case of parent companies and subsidiaries of different Member States, OJ L 21, 28.1.2015, p. 1–3), the “modified nexus approach” proposed by the UK and Germany with respect to “patent box” regimes and the recently adopted “Transparency Package”.

⁶ The signature of the MLI will indeed allow the signatories (ie. 68 on 7 June) transposing results from the BEPS project into bilateral treaties worldwide. In practice the MLI modifies the application of thousands of bilateral tax treaties concluded to eliminate double taxation. It also implements agreed minimum standards to counter Treaty Abuse and to improve dispute resolution mechanisms while providing flexibility to accommodate specific tax treaty policies. The full text of the MLI is available at: <http://www.oecd.org/tax/treaties/multilateral-convention-to-implement-tax-treaty-related-measures-to-prevent-BEPS.pdf>

⁷ A proposal for a Common Consolidated Corporate Tax Base has been on the table of the EU Member States for some time and has already been rejected once. The first draft included common rules to determine net taxable income, cross border consolidation of losses and apportionment on the basis of a formula that would *inter alia* take into consideration place of sales. The CCCTB proposal is thus different from the DBCFT, albeit tends towards greater connection between taxing powers and place of sales.

⁸ Leading articles on the topic include Avi-Yonah (2000): “Globalization, Tax Competition and the Fiscal Crisis of the Welfare State”, Harvard Law Review 113(7), 1573-1676; S. Bond, M. Devereux (2002): “Cash Flow Taxes in an open economy”, Centre for Economic Policy research Discussion Paper Series, Discussion paper 3401; M. Devereux, P. Birch Sorensen (2006): “The Corporate Income Tax: International trends and options for fundamental reform”, European Commission Economic Papers 264; A. Auerbach, M. Devereux and H. Simpson (2010): “Taxing Corporate Income” in J. Mirrlees et al. (Eds), Dimensions of Tax Design: The Mirrlees Review (Oxford University Press), 837-893; A. Auerbach and M. Devereux (2012): “Consumption and Cash-Flow taxes in an International Setting”, Oxford University Centre for Business Taxation, Working Paper 12/14, M. Devereux, R. de la Feria (2014): “Designing and Implementing a Destination-Bases Corporate Tax”, Oxford University Centre for Business Taxation Working Paper 14:07; A. Auerbach, M. Devereux, M. Keen, J. Vella (2017): “Destination-based Cash Flow Taxation”, Oxford University Centre for Business Taxation, WP17/01 and Reuven, S. Avi-Yonah (2017): “Destination based corporate tax: an alternative approach”, Public Law and Legal Theory research paper Series, Paper n° 529, Law & Economics research paper Series, Paper n° 16-028. To be noted that Auerbach already mentioned the concept in a 1997 article published in the American Economic Review (Auerbach, Alan J. (1997): “The Future of Fundamental Tax Reform”, in the American Economic Review, 87(2): 143-146.

⁹ US Republican Party (2016): “A Better Way, Our Vision for a Confident America”, available at: http://abetterway.speaker.gov/_assets/pdf/ABetterWay-Tax-PolicyPaper.pdf

¹⁰ J. Becker and J. Englisch, A European Perspective on the US Plans for a Destination Based Cash Flow Tax, Oxford University Centre for Business Taxation, WP17/03.

¹¹ See the “Tax Reform for Economic Growth and American Jobs” one pager published by the US Administration on 26 May 2017.

when the seller is an offshore company. This is an issue that has thus far, in the author's view, not yet been satisfactorily addressed.

2. DBCFT proposals, their rationale and pitfalls

2.1. From the economic literature proposals ...

Proposals for a DBCFT have appeared in the economic literature in the early 2000s.¹² DBCFT have three main properties. First, their gross tax base includes all sales receipts (hereafter "R-base" model, following the Meade Committee terminology) and possibly also net financial inflows including new borrowings and interest received (hereafter "R+F base" model, following the Meade Committee terminology).¹³ Second, local production costs are immediately deductible from the gross tax base (including labour costs and repayment of borrowing and interest payments, which means full deduction upon purchase rather than depreciation over time). In an R+F-base approach, all cash outflows including lending, repaying borrowing and interest payment would also be deductible but not under an R-base approach. In the case of a loss (investments exceeding taxable sales), companies could be entitled to a refund of the production costs or a tax credit to be offset against any other tax liability. They could also be allowed to carry forward. Third, exports are zero-rated and imports are taxed. In the case of a taxed B2B import, a deduction is available for the purchaser (production cost). Alternatively, B2B imports can be left untaxed but in this case there will be no deduction for the purchaser.¹⁴ This third feature (the destination based element) would be a major change of the international norm governing taxing rights allocation.¹⁵

In practice the DBCFT would work quite similarly to a VAT. There are some major differences, however.

On the one hand, a fundamental difference is that a DBCFT is a (direct income) tax that targets corporate profits while a VAT is a(n indirect) tax that targets consumption. The DBCFT model uses "destination" as a proxy to allocate taxation rights over corporate profits - a proxy that is traditionally used for taxing consumption - in order to achieve a number of goals (see section 2.3.). This, however, does not change the tax base and does not mean, from a legal viewpoint, that corporate taxation would be replaced by consumption taxation.

On the other hand from a more technical viewpoint, a first major difference is that under a DBCFT all investments incurred for local input (including labour costs) are deductible (whereas labour costs are not deductible in a VAT system but all other production costs are in principle deductible or recoverable no matter where they are incurred).¹⁶ A second difference is that under the R+F base model, financial

¹² See footnote 8. See also OECD (2007): *Fundamental Reforms of Corporate Income Taxes*, OECD Tax Policy Study Report n° 16, p. 145.

¹³ Pros and Cons of the R-base and the R+F base approaches are discussed in A. Auerbach, M. Devereux, M. Keen, J. Vella (2017): "Destination-based Cash Flow Taxation", Oxford University Centre for Business Taxation, WP17/01, p. 45 ff.

¹⁴ A. Auerbach, M. Devereux, M. Keen, J. Vella (2017): "Destination-based Cash Flow Taxation", Oxford University Centre for Business Taxation, WP17/01, p. 16.

¹⁵ At the moment the dominating principle in international business taxation is the source country principle whereby business profits are to be taxed "at source", which means at the location of production. Transfer prices are required in the case where there would be several places of production.

¹⁶ A. Auerbach, M. Devereux and H. Simpson (2010): "Taxing Corporate Income" in J. Mirrlees et al. (Eds), *Dimensions of Tax Design: The Mirrlees Review* (Oxford University Press), 837-893.

services would be included in the tax base (whereas they are usually exempt for VAT purposes). A third difference is that the VAT is traditionally levied on the basis of the credit-invoice method, while the DBCFT would be levied on the basis of annual assessments in each jurisdiction. A last element to take into consideration is that SMEs, non-profit (and public bodies in most VAT jurisdictions) are typically VAT exempt.

To be noted that an alternative to the DBCFT consisting in introducing a broad-based and single rate VAT (or increasing existing VAT rates and aligning them) combined with a reduction of the taxes on payroll (a labour tax cut) by the same proportion (hereafter “VAT+LTC”) is also being studied.¹⁷ In this case the tax base changes radically and, from a legal perspective, the nature of the tax changes (from direct to indirect – different taxpayer) and the tax burden is shifted from corporate profits to consumption expenditures. However, a VAT+LTC and a DBCFT would, in economic terms, be equivalent.¹⁸ In practice the VAT+LTC option would require to introduce a VAT or to raise existing VAT rate. In the case of an existing VAT system, one standard rate should be applied (and multiple rates abolished) and traditional exemptions applied for social considerations should be suppressed. In order to tackle financial services (which are being exempt for technical rather than social considerations), a specific cash flow tax should also be introduced. The VAT+LTC option thus seems easier to implement in jurisdictions not yet having a VAT system that are able to start from a blank page. This having been said, introducing a VAT is never an easy step because it has an immediate impact on prices, even if it may be expected that the reduction of labour taxes will eventually neutralise the price rise. It has also been highlighted that the payroll subsidy element might not always be easy to implement, typically in the absence of extensive payroll taxes.¹⁹

Also to be noted that the economic literature is not advocating for a blunt replacement of the CIT with a DBCFT. The scholars indeed consider a “gradual replacement” or even implementation “in isolation”.²⁰ Gradual implementation would also probably be easier in the case of the VAT+LTC option.

2.2. ... To the Ryan Blueprint

In June 2016, the US Ways and Means Committee released a Blueprint for possible future tax reforms entitled: “A Better Way – Our Vision for a Confident America” (The Ryan Blueprint).²¹ A key element of the Ryan Blueprint is the proposal to drastically reform the US CIT system as we know it and to introduce a form of DBCFT.²²

¹⁷ A. Auerbach, M. Devereux, M. Keen, J. Vella (2017): “Destination-based Cash Flow Taxation”, Oxford University Centre for Business Taxation, WP17/01.

¹⁸ The key elements that would be needed to, respectively transform a typical CIT into a DBCFT and to adopt the VAT-based approach are summarised in A. Auerbach, M. Devereux, M. Keen, J. Vella (2017): “Destination-based Cash Flow Taxation”, Oxford University Centre for Business Taxation, WP17/01, p. 65 ff.

¹⁹ A. Auerbach, M. Devereux, M. Keen, J. Vella (2017): “Destination-based Cash Flow Taxation”, Oxford University Centre for Business Taxation, WP17/01, p. 67.

²⁰ A. Auerbach, M. Devereux, M. Keen, J. Vella (2017): “Destination-based Cash Flow Taxation”, Oxford University Centre for Business Taxation, WP17/01, p. 20.

²¹ US Ways and Means Committee, A Better Way – Our Vision for a Confident America, available at: <https://abetterway.speaker.gov>

²² For a summary description of the Ryan Blueprint, see part I of R.S. Avi-Yonah and K. Clausing, Problems with Destination-Based Corporate Taxes and the Ryan Blueprint, Colum. J. Tax L. 8, no. 2 (2017), pp. 229-55.

However, an important difference between the Ryan Blueprint and the form of DBCFT proposed in the economic literature is that tax losses incurred by US companies would not be refunded or converted into a tax credit, but rather infinitely carried forward. In the case of pure exporters (whose revenue are exempt under a DBCFT), there would therefore be no possibility to recover these costs.²³

Also to be noted that the Ryan Blueprint proposes to, legally speaking, leave B2B imports untaxed but to indirectly tax them by denying the business purchaser a deduction for the cost of imported products, services and intangibles (which as indicated above is the alternative to the “purest” situation where B2B imports would be taxed and the business purchaser could deduct the purchase as a production cost).

Finally, a unilateral implementation is considered by the Ways and Means Committee while the scholars who have developed the concept of a DBCFT recommend a global implementation or at least simultaneous implementations by a large group of countries.²⁴

2.3. Rationale for a DBCFT

In general, taxing at destination (at the place of residence of the customer) has the advantage of associating the tax with a proxy that is not mobile (or at least much less mobile than other proxies) and therefore is expected to not change as a result of introducing the tax.²⁵ As a consequence, a DBCFT would thwart profit shifting as currently occurring widely through lendings from a low tax country to a high tax country, through locating intangible assets that earn a royalty or licence payment in a low tax country and through manipulated transfer prices.²⁶ Moreover, it would also suppress tax rate competition (as the applicable tax rate would only depend on the location of the customer, which is a rather immobile proxy as just mentioned). This having been said, the consequences would probably be much different in the case of a unilateral implementation as compared to a global implementation or at least compared to an implementation by a group of States (at the EU or OECD levels for example). As a matter of fact, the positive effects in terms of thwarting aggressive tax planning strategies would still be acquired by a State acting unilaterally, but new opportunities of tax avoidance by companies located outside of its territory would arise.²⁷ An additional concern in the case of unilateral implementation is the potential risk of double taxation (probably no credit available).

²³ Becker and Englisch note that these may actually become attractive targets for mergers and acquisitions by companies with a positive taxable income in the US. See J. Becker and J. Englisch, A European Perspective on the US Plans for a Destination Based Cash Flow Tax, Oxford University Centre for Business Taxation, WP17/03, p. 6.

²⁴ See A.J. Auerbach and D. Hotlz-Eakin (2016): “The Role of Border Adjustments in International taxation”, American Action Forum. Also in that sense (although considering the two options of a unilateral and a multilateral implementation): A. Auerbach, M. Devereux, M. Keen, J. Vella (2017): “Destination-based Cash Flow Taxation”, Oxford University Centre for Business Taxation, WP17/01

²⁵ M. Devereux, R. de la Feria (2014): Designing and Implementing a Destination-Bases Corporate Tax”, Oxford University Centre for Business Taxation Working Paper 14:07, p. 2.

²⁶ More detailed explanations are offered in A. Auerbach, M. Devereux, M. Keen, J. Vella (2017): “Destination-based Cash Flow Taxation”, Oxford University Centre for Business Taxation, WP17/01, p. 40 ff.

²⁷ A. Auerbach, M. Devereux, M. Keen, J. Vella (2017): “Destination-based Cash Flow Taxation”, Oxford University Centre for Business Taxation, WP17/01, p. 5. For more on possible effects of a unilateral implementation (and means to adjust the system in case of unilateral implementation), see J. Becker and M. Jung, Unilateral Introduction of Destination-Based Corporate Income Taxation, available at: https://editorialexpress.com/cgi-bin/conference/download.cgi?db_name=PET15&paper_id=377

A DBCFT also has the advantage of ensuring equal treatment to debt and equity as a source of finance. Under an R-base model, financial flows are excluded (irrespective of whether they are associated with debt or equity). Under an R+F base model, all financial flows are taken into account. Accordingly, there is no need for rules to police the distinction between the two and it also suppresses the need for complex anti-avoidance rules such as CFC rules, thin capitalisation rules and exit tax rules.²⁸ But again, a unilateral implementation would run the risk of double taxation.

Interestingly also, the fact that multinationals are not paying CIT where they make sales is nowadays perceived by the public as amounting to tax avoidance and to an unfair sharing of the overall tax burden. In contrast, taxing profits where the sales are being made would allow aligning taxation and value creation and would be perceived as being “fairer”.

A (wide implementation of a) DBCFT would thus address many of the failures of current CIT systems.²⁹ However, it would also mean that “destination” would become the proxy for allocating taxing rights over corporate profits. A discussion over the legitimacy or theoretical ground of such a proxy would go beyond the scope of this paper but the author concurs with the view that States’ “entitlement” to the tax originating within their border, as a recognised basis for source taxation, can also apply to destination based taxation.³⁰ It may also be argued that selling goods and services to a local customer base creates a “genuine link” between the taxpayer and the destination country which is a legitimate basis for taxation.³¹ Some authors, however, highlighted that from an inter-nation equity perspective, net exporting States would provide infrastructure, legal protection and other goods and services to companies but would receive no tax revenue while net importing states would tax without having providing such “benefits” to companies.³² Other (assuming a wide implementation) suggest that in view of the fact that a DBCFT permits to thwart base erosion and profit shifting, all States should eventually be able to maintain or increase their tax base.³³

The US is thus far the only jurisdiction where a DBCFT is officially considered as a possible option to reform the current system of taxation of corporate profits. At the moment the US has a quite high CIT rate (35%), which encourages offshore intellectual property (IP) and manufacturing. In addition, the US also applies a worldwide tax system (thus also taxes dividends from foreign subsidiaries). Because they do not have a VAT, the perception from a US perspective is that while US company pay a high CIT and moreover have to add VAT on the products that they sell to the EU (or to any other jurisdictions applying a VAT), importers to the US usually benefit from lower CIT and moreover do not have to add a VAT on

²⁸ A. Auerbach, M. Devereux, M. Keen, J. Vella (2017): “Destination-based Cash Flow Taxation”, Oxford University Centre for Business Taxation, WP17/01, p. 31.

²⁹ A. Auerbach, M. Devereux, M. Keen, J. Vella (2017): “Destination-based Cash Flow Taxation”, Oxford University Centre for Business Taxation, WP17/01, p. 7.

³⁰ M. Devereux, R. de la Feria (2014): Designing and Implementing a Destination-Bases Corporate Tax”, Oxford University Centre for Business Taxation Working Paper 14/07, with reference to R. Musgrave and P. Musgrave (1984): Public Finance and Theory in Practice, McGraw-Hill.

³¹ W. Schön (2016): “Destination-Based Income Taxation and WTO Law: A Note”, Max Planck Institute for Law and Public Finance Working Paper 2016-03, p. 1.

³² A. Auerbach, M. Devereux, M. Keen, J. Vella (2017): “Destination-based Cash Flow Taxation”, Oxford University Centre for Business Taxation, WP17/01, p. 34.

³³ M. Devereux, R. de la Feria (2014): Designing and Implementing a Destination-Bases Corporate Tax”, Oxford University Centre for Business Taxation Working Paper 14/07, p. 13.

their prices when selling to US customers. This would therefore result in an “unlevel playing field”.³⁴ With a view to address this situation, the Ryan Blueprint proposes to lower down CIT rates (20% for corporations; 25% for pass-through businesses), to repeal worldwide tax on dividends from foreign subsidiaries (replacing it with a participation exemption regime similar to those in force in several EU countries) and to disincentive offshoring by changing to destination-based cash flow tax. In addition, the US tax code (known for its complexity) would be simplified by broadening the base and treating debt similar to equity. The expected result is that the incentive created by the US tax system to locate operations outside of the US will be removed and that US products would compete on a more equal footing in both the US and the global market.³⁵

It is noteworthy that on 26 April 2017 the US Administration summarized the President's current ideas for a “Tax Reform for Economic Growth and American Jobs” in a one-page proposal that slightly deviates from the Ryan Blueprint. The proposal is very succinct, only including the following bullet points for what concerns “business taxation”:

- 15% business tax rate
- Territorial system to level the playing field for American companies
- One time tax on trillions of dollars held overseas
- Eliminate tax breaks for special interests

The envisaged business tax rate (15%) would therefore be lower than the 25% proposed under the Ryan Blueprint and the Border Adjustment Tax is no longer mentioned. In fact, due to the current political situation in the US (and the prominence of the health care bill), one may doubt that any major tax reform could be completed by the end of the year. This development should hopefully not halt the work done in academia regarding the potential advantages of a DBCFT or an equivalent VAT/LTC.

2.4. Compatibility with bilateral Treaties and with WTO law

The legal pitfalls of the DBCFT and the Ryan Blueprint have already been extensively discussed in the literature³⁶ and are only briefly mentioned here in the context of this paper that focuses on tax collection.

A first issue concerns the impossibility for non-residents businesses making sales into a country applying the DBCFT to deduct their production costs. As a matter of fact, the gross taxation of imports proceeds would contravene Article III of the GATT which prohibits internal tax systems that discriminate imports

³⁴ R.S. Avi-Yonah and K. Clausing, Problems with Destination-Based Corporate Taxes and the Ryan Blueprint, *Colum. J. Tax L.* 8, no. 2 (2017), p. 234.

³⁵ Ryan Blueprint at 26-27. See however J. Becker and J. Englisch, A European Perspective on the US Plans for a Destination Based Cash Flow Tax, Oxford University Centre for Business Taxation, WP17/03 for a radically different analysis of the potential effects on US businesses of a unilateral implementation of a DBCFT by the US.

³⁶ See for example Wolfgang Schön, Destination-Based Income Taxation and WTO Law: A Note, *Max Planck Inst. for Tax Law and Pub. Fin.*, Working Paper No. 03, 2016; Wei Cui, Destination-Based Taxation in the House Republican Blueprint, 173 *Tax Notes Today* 7 (2016); R.S. Avi-Yonah and K. Clausing, Problems with Destination-Based Corporate Taxes and the Ryan Blueprint, *Colum. J. Tax L.* 8, no. 2 (2017), pp. 229-55; J. Becker and J. Englisch, A European Perspective on the US Plans for a Destination Based Cash Flow Tax, Oxford University Centre for Business Taxation, WP17/03.

by according less favourable treatment to them than to “like” or “competing” domestic products.³⁷

A second point of concern regarding WTO compliance is that the exemption of exports (proper to the border adjustment feature of the tax) would likely qualify as a prohibited export subsidy within the meaning of Article XVI GATT, 3.1.(a) ASCM because the DBCFT is nothing more than a modified consumption-style tax imposed on an income base which, as such, is not a border adjustable tax under the WTO rules (only indirect taxes are border adjustable).³⁸

Third, considering the DBCFT would still qualify as an income tax, basically all bilateral double tax Treaties would have to be terminated or amended (for example the requirement under Article 7 of the OECD Treaty Model that an enterprise should have a permanent establishment on the territory of the taxing State for that State to be allowed to tax its profit should be removed). In the case where the DBCFT were not to be considered as falling within the ambit of bilateral tax Treaties,³⁹ a State not applying the DBCFT would not be obliged to grant any credit against the tax levied by a State applying a DBCFT.⁴⁰

As noted above, scholars have noted that implementing a VAT (or increasing a VAT rate) combined with a payroll subsidy would – in economic terms – achieve the same result as a DBCFT (the VAT+LTC option). In this case, importers and exporters would be allowed to deduct their input VAT no matter where it was incurred and an additional payroll subsidy would be available locally to give a relief that would be similar to a labour tax cut. A lower payroll tax as a separate tax measure would not fall within the scope of Article III GATT.⁴¹ It would not be a prohibited (export) subsidy either, because neither export related nor specific. Moreover, this combination would not fall under the ambit of double tax Treaties.⁴² In view of the above, the question arises whether the VAT+LTC does not receive more attention, the more so in view of the fact that international recommendations regularly push in the direction of a shift from direct income taxes towards indirect (broad based) consumption taxes in both developed and less developed economies.⁴³

³⁷ The question may be raised whether it would contravene Article III:2 GATT that prohibits the taxation of imports “in excess” of like domestic products because a DBCFT, as a direct tax, does not apply on products (although the wording of Art. III par.2 GATT does not only apply to “internal taxes” but also to “internal charges of any kind” and prohibits “direct and indirect” tax discrimination). But in any case it would contravene Article III:4 that prohibits tax systems according less favourable tax treatment to imports than to like products of national origin (In that sense *See*: United States — Tax Treatment for “Foreign Sales Corporations”, DS108 and confirmation in *Argentina – Measures Relating to Trade in Goods and Services* (DS453).

³⁸ Pursuant to a 1970 GATT Working Party Report on Border Tax Adjustments (available at: https://www.wto.org/gatt_docs/English/SULPDF/90840088.pdf) and the explanatory notes to Article XVI GATT in Annex I and in footnote 1 to Article 1.1.(a)(1)(ii) ASCM. See also R.S. Avi-Yonah and K. Clausing, Problems with Destination-Based Corporate Taxes and the Ryan Blueprint, *Colum. J. Tax L.* 8, no. 2 (2017), p. 239. To be noted that the Ryan Blueprint holds that the proposal does not raise any WTO compliance concerns because the cash flow focus of the tax amounts to a consumption based approach. However, the Ryan proposal admittedly maintains some typical features of the income tax, such as the use of a tax-inclusive rate, the taxation of net investment income, the flow-through treatment of partnerships and the deduction of wages.

³⁹ As suggested by A. Auerbach, M. Devereux, M. Keen, J. Vella (2017): “Destination-based Cash Flow Taxation”, Oxford University Centre for Business Taxation, WP17/01, p. 82.

⁴⁰ A. Auerbach, M. Devereux, M. Keen, J. Vella (2017): “Destination-based Cash Flow Taxation”, Oxford University Centre for Business Taxation, WP17/01, p. 82.

⁴¹ It would also not fall within the scope of Article XVII GATS.

⁴² Similar conclusions by (President’s Advisory Panel, 2005; Hufbauer, 1996; Schön, 2016.)

⁴³ The IMF and the WB usually expect from developing countries to which they are lending funds that they start levying value-added-taxes as part of the reform of their tax system. A. Schenk, O. Oldman, *Value-added-tax, a Comparative Approach* (Cambridge Tax Law Series, 2007), p. 18.

This having been said, and as noted already, in this case the tax burden on consumption would become heavier. In spite of an arguable economic equivalence, it may be difficult to convince citizens that increasing consumption taxes and at the same time reducing taxation on corporate profits would be a fair development (keeping in mind that the immediate effect would be a rise in prices and that, in short term at least, it would not entirely be compensated by the reduction of labour tax costs).

2.5. Summary

Summing up, the idea of a DBCFT has flourished in the economic literature as a possible means to address major deficiencies of current CIT systems including an increasing complexity, a discrimination of investment source (debt/equity) and opportunities for profit shifting practices. More recently it has been taken up by the US Ways and Means Committee as a possible means to relaunch and protect US production (although the fate of a major tax reform in the short term remains uncertain).

Most of the academic discussion has thus far focused on the DBCFT tax base and the compatibility of the tax with bilateral Treaties and WTO law. In contrast, only little discussion has taken place concerning the issue of tax collection. The remainder of this paper will focus on that aspect. In spite of very little reference to the question in the literature, it indeed seems of utmost importance to assess to what extent a DBCFT or the economically equivalent VAT+LTC would be “collectable” or “enforceable”, in particular in the case where the taxpayer is an offshore company.

3. Collecting a destination based cash flow tax

3.1. When is it a challenge?

In the case of domestic sales the DBCFT is to be levied from resident businesses. Resident business may submit tax returns and the tax administration is able to monitor the declarations through traditional risk assessment procedures and audits (taxpayers are within jurisdictional reach).

In the case of imports the DBCFT is to be levied from offshore businesses (beyond jurisdictional reach). In this case, States will encounter similar difficulties than under the VAT system to ensure the payment of the tax. As indicated above, one way to simplify the matter is to leave B2B imports completely untaxed and to disallow the deduction for the purchaser (rather than taxing them, with a deduction then available for the purchaser).⁴⁴ This is the option taken in the Ryan Blueprint (in this case collection is only an issue in the case of B2C imports). However, it may prove difficult to distinguish between B2B and B2C supplies, both for the supplier and for the tax administration having to monitor the correct application of the tax.

The existing literature refers to a collection procedure designed in the EU in the area of VAT as a possible way forward to collect the DBCFT in cross-border situations. Upcoming sub-section 3.2. and 3.2. seek to clarify why current VAT collection models for cross-border supplies have not proven fully

⁴⁴ A. Auerbach, M. Devereux, M. Keen, J. Vella (2017): “Destination-based Cash Flow Taxation”, Oxford University Centre for Business Taxation, WP17/01, p. 16.

satisfactory and why, in particular, the EU so-called “MOSS system” should, in the author’s opinion, not serve as model to collect a DBCFT on imports. Sub-section 3.4. then investigates possible alternatives.

3.2. Vendor registration as the traditional model for collecting VAT – domestic v. cross-border situations

Vendor collection is the backbone of the VAT system as designed in the 1950s.⁴⁵ It has contributed to the revenue generating capacity of this tax on consumption and consequently to its impressive success (more than 160 countries nowadays apply a form of VAT).⁴⁶ At a time when the bulk of transactions were domestic, relying on businesses to collect the tax (as part of the sales price) indeed proved to be an efficient and effective way to proceed. This is because of the limited number of tax collectors (as compared to final consumers) and the advantage of the deduction method as a means to ensure neutrality for businesses and to incentivise tax collection (all input VAT, i.e. production costs except labour costs, is in principle deductible against output VAT, i.e. the VAT charged to the customer).

Another major paradigm of the VAT system is that, in a cross border situation, the tax should ideally be levied in the jurisdiction of presumed consumption: “at destination”. This is reflected in the “International VAT/GST Guidelines” issued by the OECD and in international practice.⁴⁷ The reason is that such an allocation of taxing rights avoids distortion of competition among suppliers from different jurisdictions, as the same VAT burden will apply in the domestic marketplace irrespective of the location of the supplier (thereby avoiding forum shopping).

In a cross border scenario, however, a major weakness of the vendor collection model under a destination based system is that a disconnect arises between the substantive jurisdiction of the taxing States (ie. the right to levy the tax) and enforcement jurisdiction (i.e. the means to enforce the collection of the taxes)⁴⁸ because in such a scenario, the tax collector is located offshore and States jurisdictional powers are limited to national boundaries (taxpayers are “beyond jurisdictional reach” as indicated above). For the reasons mentioned above the application of the destination principle should not be called into question because the alternative (an origin based taxation, i.e. taxation in - and at the rate of - the jurisdiction of the supplier) would create an incentive for customers to purchase from suppliers located in low VAT jurisdictions and would in turn incentivise businesses to locate in such low VAT jurisdictions in order to be able to offer lower prices. The solution should therefore rather lie in designing an appropriate collection model for implementing a destination based system in a cross-border scenario.

⁴⁵ Von Siemens first proposed the concept of a value-added-tax in 1919 (C.F. von Siemens, *Veredelte Umasatzsteuer* (Siemenstadt, 1919). In 1921, Adams developed the “credit invoice method” to prevent tax cumulation in view of a potential implementation in the US, which, however, never materialised (Th. S. Adams, *Fundamental Problems of Federal Income Taxation*, 35 Quarterly Journal of Economics, p. 527 (1921). France was eventually the first country to introduce a value-added-tax in 1954 (Introduced by the Act n° 54-404 of 10 April 1954. Journal Officiel of 11 April 1954 and Rectificatif Journal Officiel of 20 May 1954),⁴⁵ based on the proposal of Lauré, then joint director of the French tax authority (M. Lauré, *La Taxe sur la valeur Ajoutée* (Sirey, 1952).

⁴⁶ OECD Consumption Tax Trends 2016, p. 19.

⁴⁷ OECD International VAT/GST Guidelines. At the moment, the guidelines only cover services and intangibles.

⁴⁸ The concepts of “enforcement jurisdiction” v. “substantive jurisdiction” have been developed by Walter Hellerstein. See for example W. Hellerstein, *Jurisdiction to impose and enforce Income and Consumption Taxes: Towards a Unified Conception of Tax Nexus in Value-added-taxes and Direct Taxation*, eds. M. Lang, P. Melz and E. Kristoffersson (IBFD, 2009), p. 545.

When international trade started developing, the bulk of cross-border trade concerned tangible assets. Procedures other than based on a pure vendor model have been put into place for imports of goods in order to avoid a situation where the taxpayer would be located offshore (usually “customs procedures” whereby tax assessment and collection is being effected, or at least monitored, by customs authorities).⁴⁹ In contrast, inbound services have, for a long time, remained untaxed. However, when the volume of cross-border trade in services and intangibles started to increase, several States decided that they could not afford leaving these supplies untaxed indefinitely.⁵⁰ The vendor collection model is currently presented by the OECD as the best alternative for collecting VAT on inbound services and intangibles to private consumers, in spite of the lack of enforcement jurisdiction of the taxing states under this model.⁵¹

With a view to “encourage” compliance of offshore vendors, the EU has since 2003 been providing for an (optional) simplified vendor registration system for non-EU businesses supplying electronic services and intangibles (“electronically supplied services” in EU language) to EU final consumers. Under this system, the non-EU suppliers are being offered the possibility to register in the Member State of their choice (“Member State of identification”) and to declare and pay the VAT related to all their supplies of electronic services to EU final consumers through that Member State of identification, who is then required to redistribute the revenue collected between the different Member States of consumption. This system (so-called mini “one-stop-shop” or “MOSS”) is a simplification as compared to the alternative consisting in registering in each Member State (although, in practice it still requires from suppliers that, in their single tax returns they specify, for each transaction, the place of residence of the consumer and the VAT related to the transaction in order to enable the Member State of identification to proceed to the redistribution).⁵² Unfortunately, however, the level of compliance to this (initial version of) the MOSS (see below recent developments) has been extremely low: only 539 businesses were registered in January 2014 (thus 11 years after the scheme had been put into place).⁵³ As discussed above, the main reason is that while the EU Member States may have the substantive right to tax the supplies made to their consumers, they lack the practical means to require the collection of the taxes from businesses that are located beyond their jurisdictional reach. They, in particular, lack the means to enforce compliance in the case of supplies of services and intangibles that do not cross physical borders.

⁴⁹ This concerns imports, i.e. supplies made by suppliers located in a non-EU country to EU consumers. Due to the absence of internal borders in the EU, intra-EU supplies have been subject to specific rules. On the one hand, the general rule provides that EU consumers traveling to another EU country pay the local VAT on their purchases. On the other hand, special rules have been adopted for tackling so-called “distance sales”, covering sales made over the Internet and other mail orders under which businesses with a turnover below a given threshold charge VAT at origin while businesses with a turnover above the given threshold have to register and collect the VAT in the country of destination (Article 33 and 34 of the VAT Directive).

⁵⁰ The EU acted as a pioneer by taxing inbound electronically supplied services at destination already since 2003. In the past years several other jurisdictions started to apply VAT/GST to supplies by non-resident suppliers of electronic services to final consumers in their jurisdictions, for example, Switzerland, Norway, Iceland, South Africa, Korea, Japan, Liechtenstein, Russia, Albania, India, New Zealand. Several other jurisdictions are contemplating similar systems, for example, Australia, Taiwan, Serbia, Belarus, Thailand, Turkey, Indonesia, Israel, Singapore, Tunisia, Morocco, Paraguay, Canada and Malaysia.

⁵¹ OECD International VAT/GST Guidelines.

⁵² See M. Lamensch (2015): Tax Assessment in a Digital Context: A Critical Analysis of the 2015 EU Rules, in “Value Added Tax and the Digital Economy: The 2015 EU Rules and Broader Issues”, eds. M. Lamensch, E. Traversa and S. van Thiel, Kluwer, EUCOTAX Series on European Taxation Vol. 46, p. 39.

⁵³ Most of them in the United Kingdom (266), the Netherlands (111), Germany (43), Ireland (41) and Luxembourg (28). Only 15 had registered in France, 14 in Italy, 8 in Sweden, 4 in Malta, 3 in Denmark, 2 in Spain, 1 in Belgium, Bulgaria, Cyprus and Greece, and none in Austria, the Czech Republic, Croatia, Estonia, Finland, Hungary, Latvia, Lithuania, Poland, Portugal, Romania, and Slovakia (figures communicated by the UK Treasury in January 2014).

Since 1 January 2015, a MOSS procedure is also available to EU suppliers of electronically supplied services (as well as of telecommunication and broadcasting services), with reasonable success (mid-2016, 12.899 EU businesses had registered⁵⁴). In contrast, the level of compliance by non EU businesses remains very limited: 1.079 registrations, even after the promotion campaign run by the European Commission all around the globe.⁵⁵

In spite of these figures, the EU Member States are currently discussing a proposal submitted by the European Commission to broaden the scope of the MOSS to also include imports of goods. At the moment, customs authorities are responsible for the assessment and collection of the VAT on imports of goods with a value higher than EUR 22 (goods with a value below the EUR 22 threshold are being exempt, irrespective of the supplier's turnover). However, the increasing volume of imports due to the development of e-commerce results in increasing administrative costs, including warehousing costs, for the customs authorities. In addition, it is estimated that in 2015 there was 144 million consignments benefitting from the VAT exemption (more than a 300% increase over the last 15 years). In addition to the "loss" of revenue resulting from the exemption, major frauds are detected with the possibility that VAT foregone could be as high as EUR 1 billion in 2015.⁵⁶ As a matter of fact, offshore businesses routinely make making false value declarations in order to remain under the EUR 22 threshold and to benefit from the VAT exemption. To address that situation the European Commission proposes to remove the threshold and to replace the customs procedure with a new system.⁵⁷ If the European Commission proposal is adopted, there would be two possibilities for non-EU businesses. On the one hand, suppliers willingly registering to the enlarged MOSS would benefit from a "fast track" procedure (no stop at the border) and declaration and payment of the VAT by the offshore supplier should take place via periodical returns (thus after the import and delivery to the customer has taken place). On the other hand, a fall back procedure is foreseen whereby, in the absence of MOSS registration by the offshore supplier, the person responsible for the transport of the goods would become liable for the assessment, collection and payment of the VAT, again via periodical returns. In this case, the standard rate of VAT would systematically apply and customer entitled to a reduced rate would have to introduce a separate customs declaration.

The proposal is currently being discussed by the EU Member States. As extensively discussed elsewhere, it raises a number of concerns.⁵⁸ A main concerns is that nothing is foreseen to tackle the issue of undervaluations (even in the absence of a threshold, a lower value offers a lower VAT burden). However, on the one hand a MOSS registration would offer a fast track and the only possible controls of the VAT declared and paid by offshore suppliers will be made through audits after the MOSS declarations have been made (But how efficient will audits be at that stage? What will be the available information to run the controls? How to audit offshore companies? Does the proposal take for granted that offshore businesses will duly declare and remit their taxes through the MOSS even if they know

⁵⁴ This level of registration is being presented as a major success by the European Commission. The question may however be raised whether a little less than 13.000 registrations corresponds to the number of EU businesses selling cross-border services and intangibles to EU consumers.

⁵⁵ European Commission (2016): Impact assessment accompanying Commission Proposal 2016(757), p. 74.

⁵⁶ EY Study for the Commission – available at: http://ec.europa.eu/taxation_customs/resources/documents/common/publications/studies/execsummary_lvcr-study.pdf.

⁵⁷ Proposal for a Council Directive amending Directive 2006/112/EC and Directive 2009/132/EC as regards certain value added tax obligations for supplies of services and distance sales of goods, COM(2016) 757 final.

⁵⁸ M. Lamensch, European Commission's New Package of Proposals on E-Commerce: A Critical Assessment, *International VAT Monitor*, 2017 (Volume 28), No. 2.

that States' means of control are very limited?). On the other hand, the transport sector (and in particular the postal companies) do not have the means to detect false declarations of value to a satisfactory level. A study by Copenhagen Economics indeed found that 65% of consignments from non-EU suppliers through the public postal channels were non-compliant⁵⁹ (in the case where the goods are declared as being exempt, they are fed directly into the postal flow often without any customs controls and as indicated above this simplified border crossing for low value goods is being largely abused by offshore suppliers). This is significant as it is estimated that 70% of transactions are sent through public postal channels.⁶⁰ As the MOSS would remain optional (and results in IT investments, the requirement to make periodical returns and to appoint a fiscal representative), it may be expected that the number of parcels on which VAT will have to be collected by the transporters will be substantial (meaning that frauds will become ever more difficult to monitor).

The EU VAT system has been a model for many of the VAT systems that exist around the globe. Unsurprisingly, therefore, other States are following suit and have implemented or are in the process of implementing a vendor collection model for imports of both goods and services.⁶¹ This evolution is, in the author's view, problematic, both from a business perspective (how many registrations will be necessary to run a cross-border activity if "simplified" registration systems are adopted around the globe?) and from a States' perspective (compliance cannot be properly enforced; the situation is particularly problematic for services and intangibles as in this case States do not even have the possibility to run random controls at the border).

In any case, this model does not, in the author's view, seem promising at all for collecting a DBCFT or VAT+LTC in the future, as will be further developed in the next section.

3.3. A MOSS system for collecting a DBCFT?

The question how to collect a DBCFT has largely been left aside for the moment. In fact, only Devereux and de la Feria have discussed it.⁶² In a nutshell, the scholars suggest that in both B2B and B2C imports the DBCFT could be collected on the basis of a MOSS approach, under which a given country (A) may collect the tax on behalf of another country (B). In practice, the tax authorities of both countries (collecting taxes for each other) would do an aggregate reconciliation across all transactions in a given period (though a clearing house). Enforcement jurisdiction would therefore be *passed* to another country (the one where the tax collector is established) in order to become effective, while substantive jurisdiction would remain in the country of destination. A collection fee would be retained, to be netted

⁵⁹ Copenhagen Economics, E-commerce imports into Europe: VAT and Customs treatment, 2016, available at: (<https://www.copenhageneconomics.com/publications/publication/e-commerce-imports-into-europe-vat-and-customs-treatment>) This study was carried out on behalf of UPS by making approximately 400 real purchase brought to delivery via e-commerce platforms located in US, Canada, Japan, India and China. Delivery was made to 7 destination Member States. 50% of purchases were via express operators with 50% via public postal operators. VAT was due on all the consignments and customs duties were due on 45% of the consignments.

⁶⁰ European Commission (2016): Impact assessment accompanying Commission Proposal 2016(757), p. 16.

⁶¹ Norway (since July 2011), Switzerland (since January 2010), Iceland (since November 2011), South Africa (since July 2014), Korea (since July 2015) and Japan (since October 2015). Australia should be next (and New Zealand and the Russian Federation are thinking about it). Of course, none of these States are able to offer single points of registration at a regional level like in the EU.

⁶² M. Devereux, R. de la Feria (2014): Designing and Implementing a Destination-Bases Corporate Tax", Oxford University Centre for Business Taxation Working Paper 14/07, p. 20.

out in a final settlement between countries. The scholars further suggest that the MOSS system would tackle the issue of mispricing of intra-group transactions because in the case of an export from A to B being routed through a tax haven H, export from A will be exempt, import to H would be taxed at a very low rate but would then have to tax the export to B at B's rate. H would have to collect the revenue and pay it to B, with exactly the same outcome as if the sales had been made directly from A to B.

Although in theory this proposal may seem attractive, in practice it assumes participation of all States to the MOSS system, including tax havens. More precisely, it assumes that all States would be willing to collect taxes for each other and to audit companies established within their territory for the purpose of ensuring the correct application of other States' income taxes (even in the case of a net exporting country who would thus be required to collect the taxes of other States even if it would itself end up with a negative tax base). The other way around, it assumes that States are willing to trust that other States will duly collect their taxes and conduct the necessary audits to that effect. The author is of the opinion that such a system could never be implemented in practice. Asking from States that they place the responsibility to collect their main source of revenue into the hands of many different States around the world does indeed not seem realistic at all (for example: expecting from China that they audit their businesses to make sure that they pay a correct amount of DBCFT to the US seems unrealistic).⁶³ Also, even assuming that joint audits and mutual assistance would become legally possible, it seems unreasonable to expect from States that they oblige to the many requests that would be formulated by States around the world (because complete trust cannot be expected as indicated above). It may perhaps be envisaged between the EU Member States, engaged into an economic integration process and having adopted several instruments of mutual cooperation (and still there, the question whether cooperation is effective for what concerns the MOSS remains an open question because, to the author's knowledge, MOSS audits are not taking place). In contrast, it would, in the author's opinion, never be possible with third countries.

Additional controls should then be considered, such as monitoring of inbound flows of goods. As discussed above in the area of VAT, such controls are hardly feasible, even with the implementation of a threshold (based on parcel value) and major frauds based on undervaluations are to be expected.

In the case of inbound services and intangibles, controls at the border are simply impossible. The only possibility would be to have controls carried out by the collecting States. Once again, it does not seem reasonable to expect from States that they entrust other States with the responsibility to monitor the correct declaration and payment of their income taxes.

Summing up, a MOSS system does, in the author's view, not seem promising for the collection of a DBCFT. In the case where States would consider the introduction of the VAT+LTC option, the same conclusions can be made as for the VAT system.

⁶³ Recent success in the area of exchange of information such as the setting up of a multilateral framework under the auspices of the OECD should not lead us to think that similar cooperation (that still needs to be proven effective) could take place for what concerns collection. Helping other jurisdictions by exchanging information is one thing - collecting taxes for each other is a very different type of commitment.

3.4. Alternative collection methods

3.4.1. Reconciling substantive and enforcement jurisdiction under a customer or a third party collection model

The rather negative conclusion in the previous section regarding the option to rely on a MOSS procedure to collect a DBCFT or a VAT+LTC on offshore vendors invites a debate regarding possible alternatives. The issue is important because a State willing to introduce a DBCFT cannot afford to not be able to enforce the payment of the tax on imports (in particular in view of the booming development of e-commerce and of a “digital economy” in general).

The key, in the author’s view, is not *to pass enforcement jurisdiction* to someone else but to look for a means *to reconcile* substantive and enforcement jurisdiction.

One way to reach that objective would be to focus on the customer who would always be within jurisdictional reach of the taxing state. Customer collection is already applied in some cases of business to business (B2B) supplies (for example in the EU: the “reverse charge” system). In fact, as indicated above, B2B supplies could be left out of the tax base in the case of a DBCFT (an option that has been adopted by the Ryan Blueprint). However, a major difficulty is to distinguish between B2B and B2C supplies.

For what concerns cross-border supplies to final consumers (B2C supplies), both the US (subnational States) and Canada have been marginally applying customer collection rules for consumption taxes, albeit with very low levels of compliance so that international policy guidelines advise against it. Moreover, customer collection models have been largely ignored so far in the VAT literature, often without much consideration. For example, Devereux and de la Feria hold that “*two options open to the destination country are to collect the tax from the company or from the customer. The former appears to be the more realistic option, although not without difficulties of its own, especially in the absence of fiscal borders or for digital products, as is clear from the operation of VAT*”.⁶⁴ Unfortunately, and in spite of the obvious shortcomings of the vendor collection model, the scholars do not further investigate customer collection as a possible option.

The main reasons traditionally argued to reject customer collection in the case of B2C supplies include the fact that final consumers neither have the skills to voluntarily proceed to the remittance of the tax, nor any incentive to do so in view of the fact that tax administrations have limited means to track the supplies. The need to audit millions of taxpayers is also perceived as a major obstacle.

However, with a novel method (based on the opportunities offered by new technologies), making it very simple for customers to pick up and allowing the tax administration to track any single transaction generating the right to levy a tax, the author suggests that these drawbacks could be removed. Once this is done, the author argues that – at least for what concerns VAT (and sales taxes) – a customer collection model would outperform a vendor collection model against the traditional benchmark of a “good tax system” laid down by the OECD (neutrality, effectiveness, efficiency, simplicity and certainty,

⁶⁴ A. Auerbach, M. Devereux, M. Keen, J. Vella (2017): “Destination-based Cash Flow Taxation”, Oxford University Centre for Business Taxation, WP17/01, p. 81.

proportionality and flexibility).⁶⁵ The two main reasons are, first, that enforcement (effectiveness)⁶⁶ would be greatly facilitated in the first place because the VAT due would in principle no longer leave the territory of the taxing State and therefore substantive jurisdiction and enforcement jurisdiction would finally be realigned, reducing or even suppressing the need for international cooperation (while, under the vendor collection model, VAT paid by the customer to the foreign supplier first leaves the territory of the taxing State, and is then supposed to be remitted to the taxing state by the foreign supplier, but without certainty that this will be done and with mutual assistance as the only means to monitor the situation). Second, because appropriate processes and big data technology have the potential to enable the tax administration to identify when a VAT is due, and to ensure its collection in a timely and simple fashion (simplicity). Efficiency would also be maximized, on the one hand, because audit procedures would be streamlined on the basis of automatically generated data and, on the other hand, because verification obligations for suppliers would be removed (also offering legal certainty, simplicity and proportionality), which would finally allow micro and small and medium sized enterprises to compete on an equal footing with multinationals (neutrality). In addition, risks of double taxation or unintended non-taxation in the case of supplies made via platforms will also be removed (again: effectiveness, and also neutrality in the sense that double taxation is an impediment to trade).

The author is currently working on two models that seek to create a “geo-fence” around VAT jurisdictions⁶⁷: the iVAT and the PAYS models.⁶⁸ In practice, the PAYS and iVAT solutions do monitor inbound movements of goods and outbound payments with the objective to support VAT declaration and payment by the customer. In a nutshell, under the PAYS system goods entering the country are being tagged upon import and tracked until delivered (a series of “events” are being pushed on a government portal which provides full visibility to the tax administration). Once the goods are delivered, the customer is invited to declare and pay the VAT (big data technology is being used to monitor declarations and payments). As to the iVAT model, it supports customer collection of VAT through a secure VAT gateway that funnels payment transaction data to a secure government portal and pre-fills the VAT declarations for the customer. If applied in combination, the data related to inbound movements of goods and outbound payments can be reconciled for even more robust protection against fraud.

Another possibility would be to make a “local” third party liable for the collection of the tax, such as the financial intermediary processing the payment. Such a model usually raises doubts regarding the feasibility and opportunity of involving financial intermediaries into tax collection, mostly for reasons of liability and costs allocation (they are, for that reason, also largely ignored in the literature). However, it

⁶⁵ See OECD (2014): “Fundamental Principles of Taxation, in Addressing the Tax Challenges of the Digital Economy, OECD/G20 Base Erosion and Profit Shifting Action 1, Chapter 2.

⁶⁶ Economists will know that the OECD and legal scholars give a different meaning to the terms “efficiency”, “neutrality”, “effectiveness” etc. than is being given in the economic literature. OECD/Legal terminology is here being used.

⁶⁷ Location based services (LBSs) are not new. Citizens use applications that rely on LBS on a daily basis (e.g. to find the nearest restaurants or for being notified about a retailers’ offer when in a close proximity of a shopping centre). In a nutshell, LBSs collate, filter, compile and deliver information based on the location of any user. “Geo-fencing” is a type of LBS, which triggers a location-based event whenever a user enters or exits a “geo-fence”, i.e. a pre-defined virtual geographical boundary. One step further, “tax geo-fencing” is the creation of a boundary (physical or virtual) around global economies with a view to mitigate tax revenue leakage due to cross-border trade.

⁶⁸ The author collaborates with an IT researcher and IT designers on this project. The underlying technology has already been developed (proof of concept stage). Please contact the author if you wish to know more about this research.

should be noted that Italy recently introduced a so-called “split payment” procedure for VAT on business-to-government supplies,⁶⁹ that Costa Rica may soon implement such a split payment procedure for VAT on business-to-consumer online sales⁷⁰ and that the UK HMRC has published a call for evidence on split payments mechanisms for cross-border VAT. Under these systems, the banks operating payments are required to collect and pay the corresponding VAT to the tax administration.⁷¹ In the same way as in a customer collection model, substantive and enforcement jurisdictions can be reconciled under such a split payment (third party) collection model.⁷²

In the author’s view, customer or third party collection models represent promising solutions for collecting VAT in the future. For the purpose of this article, the question is whether one of these models could be relied on to collect a DBCFT or the economically equivalent VAT+LTC option. Some preliminary thoughts on this question are offered in the next section.

3.4.2. A customer or a third party collection model for the DBCFT or VAT+LTC?

A third party collection model for the DBCFT

A customer collection model for the DBCFT would be conceptually challenging because, while there would be no difficulty to have the VAT(indirect consumption tax) paid by the customer “on top” of the net sales price (as they currently do when the product is imported and they have to pay the VAT upon importation), the same probably does not apply to a tax on companies’ profits (direct income tax) that should rather be “taken out” of the sales proceeds and not paid as “a supplement” by the customer. In fact, this is probably more of a challenge for lawyers (and for the citizens having to pay the tax separately) than for economists who would argue that the impact of the tax is on the customer anyway (although less visible).

In any case, a split payment procedure (third party collection model) whereby a fraction of the sales price paid by the customer is being *withheld* by the bank and paid directly to the Treasury might be preferable. Under such a system, and contrary to a MOSS approach, the taxing State would keep enforcement jurisdiction over the tax collector (banks) and would therefore be able to enforce compliance. Such a system could apply in both B2B and B2C imports.

However, technical limits of a traditional split payment system include, first, that banks should cooperate and duly collect the tax on offshore payments (they can be required to do so by law). Second, cash payments would not be covered (but in the case of imports it may be assumed that cash payments

⁶⁹ EU Council of Ministers Decision 2015/1401 of 14 July 2015 authorizing the Italian Government to introduce the split payment mechanism for all purchases by the Public Administration.

⁷⁰ See M. Tenorio (2017): “Experience with the VAT withholding regime in Costa Rica”, presentation made at the 2017 OECD Global VAT Forum on 13 April 2017.

⁷¹ For the sake of clarity, it is worth highlighting that, in contrast with a traditional split payment procedure, under a customer collection model such as the iVAT system briefly described above, banks would not have to collect the tax: they simply would have to include the possibility to pair bank accounts in order to allow payment information to be funnelled to the government portal.

⁷² The author had proposed a similar system in M. Lamensch (2015): “European Value-added Tax in the Digital Era: A Critical Analysis and Proposals For Reform”, Amsterdam, IBFD Doctoral Series, 2015, vol. 36. She however added the proposal that software fed with data extracted from banks’ KYC databases be used for an automated assessment of the VAT due.

are not really an option). Third, under such system, the offshore vendor will receive less money than he charged (and this could raise difficulties for example if the vendor then refuses to serve the client). Banks could also “charge” an additional amount when proceeding to the payment rather than withhold part of the price charged, but this would perhaps again be conceptually challenging in the case of a tax that should be paid by the seller and not the customer (once again, economists may find this nuance irrelevant).

A customer or a third party collection model for the VAT+LTC option

A third party collection model could also apply in the case of the VAT+LTC option. In this case the VAT could either be *withheld* from the amount paid by the customer or *charged on top of* the sales price charged by the supplier. The latter option avoids cases where the supplier would refuse to serve the customer and would be conceptually more acceptable for the customers (than in the case of a DBCFT) who are already used (in VAT jurisdictions) to pay the VAT separately upon importation (together with customs duties; the same applies for customers in use tax jurisdictions).

Naturally, being largely composed of a VAT, the author also suggests that a customer collection models such as the one proposed under the PAYS and the iVAT solutions could be used for the implementation of the VAT+LTC option. While the PAYS and the iVAT solutions mentioned above were developed to tackle the issue of VAT collection on B2C imports from e-commerce, there is no reason why it could not also apply to B2B imports (as it is similar to a reverse charge system, albeit more robustly addresses frauds thanks to big data technology).

As noted above, the VAT+LTC option has the advantage of not raising WTO issues. It, however, comes with other disadvantages. On the one hand for States already having a VAT system, such as the EU, it would likely require a broadening of the tax base and a simplification of the rate structure (this could be regarded as a no go; however nothing ever stays the same and countries with a complex VAT system may at some point decide to simplify their structure out of necessity – which is a recommendation that has been formulated by the IMF and the OECD for a long time anyway) and would moreover translate in a limited but immediate increase of prices (even if the price rise would eventually be neutralised by the LTC). On the other hand for a State not yet having a VAT, it would imply a (substantial) price rise for consumers (even if the price rise would again eventually be neutralised by the LTC). In federal States like the US it would moreover mean a shift of tax jurisdiction from the states to the Federation.

A greater tax burden on consumption at the same time as a reduction of the tax burden on corporate profits may also be a hard sell. As a matter of fact, even if the economic effect would be similar, citizens might consider such development as being “unfair”.

Finally, technical limits for the implementation of the iVAT solution again includes the fact that cash payments would not be covered (the solution was designed with e-commerce transactions in mind where online payments are mainstream), but again, in the case of imports it may be assumed that cash payments are usually not an option. There is not such issue with the PAYS solution, albeit this solution only captures imports of goods.

4. Conclusions

This paper focused on the question how to collect a DBCFT in the case of imports. This is a question that, in the author's opinion, has thus far not been comprehensively addressed in the literature. It mostly sought to suggest that a MOSS approach, such as the one being applied in the EU for VAT collection on inbound telecommunication, broadcasting electronically supplied services (and in the future also envisaged for imports of goods) is not the right one, essentially because of the disconnect, under such a model, between substantive and enforcement jurisdiction.

The paper then went on to discuss possible alternatives to the MOSS approach, including customer and third party collection models.

A first main conclusion is that a customer collection procedure for B2C imports would probably be "conceptually" challenging in the context of a DBCFT because, while it is conceivable to require from consumers that they pay consumption taxes separately, it would more difficult to require from them that they pay a tax on the profits generated by the company (lawyers and economists may disagree on that point). In contrast, a split payment procedure (third party collection) might be easier to implement, whereby the bank operating the payment would withhold part of the price paid by the customer and remit it directly to the Treasury (or charge it on top of the sales price).

The second main conclusion of this paper is that an economically equivalent VAT+LTC would not only raise no WTO issues but could moreover potentially be collectable via a customer collection or a third party collection model and therefore that this option may deserve further attention. However, the author also acknowledged that the VAT+LTC raises other difficulties, both for States not yet having a VAT that would have to impose a rise in prices to their consumers (although the reduction in labour taxes should itself eventually result in a reduction of prices) and for jurisdictions having long established exemptions and multiple rates structures.

These are only preliminary findings. In view of the potential advantages of taxing corporate profits at destination rather than at origin (major simplification of current CIT system, reduced opportunities for BEPS and allocation of the taxing rights to the countries in line with value creation), the author suggests that alternative collection models for imports under a DBCFT should be further researched. In the author's opinion, only collection models that would allow reconciling substantive and enforcement jurisdiction are worth being investigated.

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