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The Feasibility to Regionalise Corporate Income Taxation

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The Feasibility to Regionalise Corporate Income Taxation

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1. INTRODUCTION

1.1. This report extends the findings of an earlier study conducted on behalf of the Flemish Minister for budgetary affairs in 2007-2008 (acting through the "Steunpunt beleidsrelevant onderzoek – Begroting en fiscaliteit 2007 – 2011 funded by the Flemish Government). It further includes additional and more recent findings and insights .

The report focuses on the regionalisation of taxing and tax rules setting power. It does not deal with the, quite separate, issue of the allocation of purely federally levied corporate income taxes the proceeds of which are restituted to the regions and communities.

1.2. The basic aim of the study was to determine whether some form (and in case of a positive answer, which form or model) of regionalisation of part of corporate income tax rule setting powers is:

- in conformity with the EU law requirements, essentially the requirements relating to regional aid;

- feasible to be implemented, in the sense that it would not create a particular burden on Belgian companies (essentially in terms of compliance requirements), or at least not a burden that would be disproportionate to the intended advantages resulting from the additional economic policy tool made available to the regions;

- feasible to be implemented in the sense that it does not lead to company migration between regions. Indeed, the regional measures should not be applied on the basis of where the seat of a company is located, because changes of seat within one country can be effectuated in a tax neutral way (unlike changes of seats across borders). As a result, the regional rules should be applied with respect to the income generated in the region by companies wherever they are located (as well as to branches of foreign companies established in that region).

- entirely avoiding the creation of inter-regional transfer pricing issues.

The study reaches the conclusion that indeed three models of regionalisation can be developed that are feasible and EU consistent.

1.3. The report first presents some considerations and arguments relevant for anyone developing the case in favour or against the regionalisation of corporate income taxes in Belgium. Next it specifies three workable models for such regionalisation, and subsequently presents the technical basic requirements for making these models work (also briefly referring to transition scenario's that have been developed). In a short appendix at the end, some thoughts concerning the regionalisation of personal income taxes are presented.

2. THE CASE FOR THE REGIONALISATION OF CORPORATE INCOME TAX

2.1. Several arguments are often developed arguing why the regionalisation of corporate income taxes should not be proceeded with.

(i) From the viewpoint of corporate entities, the regionalisation of corporate income taxes would lead to substantial additional complications and compliance requirements, in view of rather limited benefits that would come from it for the corporations.

In this framework it is important to note that all available sources, including the "dry run exercise" with large Belgian corporations referred to below, have shown that the number of "multi-regional" companies is very low and would not reach 2% of all companies. In effect, it is essentially the financial institutions, for which working on a single corporate balance sheet has vital importance, and some retail chains that operate a pluri-regional company that would as a single entity be submitted to the different tax rules of the three regions.

And with respect to this very limited number of pluri-regional entities, it has been confirmed that the proposed models of regionalisation are quite workable and do not

increase tax compliance requirements in any relevant degree. This has been tested with a panel of 6 large Belgian companies who have volunteered to proceed with a "dry run" exercise where they have been splitting up the net profits of the pluri-regional companies over the three regions, on the basis of the formula developed in the framework of the models (see below). 4 out of 6 undertakings after verification returned stating that all of the group companies had been set up as uni-regional companies, so no difficulty at all occurred concerning the application of the rules relating to corporate income tax regionalisation. Two very large companies had to apply the profit split formula contained in the regionalisation models. Interestingly, the top management of one of these companies was quite explicitly opposed to corporate income tax regionalisation, whilst the top management of the second company was very supportive of the regionalisation idea. Both companies reported that applying the profit split method, and complying with the rules proposed for the different regionalisation models, did not cause any particular difficulty. In short, the models are workable and do not impose a heavy compliance burden.

(ii) A second argument often referred to as pleading against regionalisation of corporate income tax relates to the establishment of inter-regional tax competition. Again this argument is not a convincing one.

Since at present the policy tool that has been made available to the regions is the instrument of granting subsidies, the inter-regional competition occurs on that basis. And in this respect, the Walloon region has a definite competitive advantage since due to its status in the framework of EU regional policy, it has more scope and possibilities for granting subsidies in the framework of the European limitations that are imposed.

And more importantly, the competition that is of real interest to all Belgians is the economic competition with our neighbouring countries, with the eastern European countries, with India etc.. It is at that level that the real competition to attract and maintain corporate investment is occurring. Not at the intra-Belgian level because the basic financial solidarity, that should – and quite likely will- be present within Belgium, has as a consequence that economic welfare in one of the regions does benefit the entire country.

2.2. In fact, regionalisation of corporate income tax is the very logical consequence of having regionalised the essential competences relating to economic policy. As such, regionalising corporate income tax fits the idea of "more homogeneous domains of competences" adhered to by all political parties. Indeed, the major policy tools for conducting an economic policy are the granting of subsidies, taxing powers and the right to grant tax benefits, and labour market regulations.

The labour market related powers have been granted on a limited scale only, and have further been curtailed by State Council jurisprudence (stating that enhancing employment through a limited personal income tax cut would be beyond the power and authority granted to the regions, cfr. the Flemish Vlaminov/Vlaminovi saga).

The corporate income tax related power has entirely remained with the federal authorities.

Only the possibility to grant subsidies has been provided to the regions. As a result, all of the regions are forced to use a policy tool that fits more closely the economic policy approach of the Walloon part of the country, and not the approach desired to a considerable extent in the Flemish region. Also, the only policy tool that has been regionalised is the one which is more readily available to the Walloon region.

The Walloon preference for approaching economic policy, and rather efficiently so, through subsidies is underscored by the fact that a number of Walloon economists would calculate total tax burden on enterprises whilst deducting the total amount of subsidies, thereby overlooking that subsidies are not generally available to all taxpayers meeting certain criteria, but are granted on the basis of individual attribution decisions.

As a result, it is only logical to regionalise certain powers relating to corporate income taxes in order to grant to the regions the basic, but full, tool kit required to conduct an economic policy.

It can be noted that this argument pro regionalisation is independent from queries relating to linking regional budgets to regional taxing revenues. Indeed, a tax policy tool can take the form of rate cuts or specific deductions/credits the cost of which is taken directly against the regional budget (as a subsidy would).

Regionalisation of corporate income tax would no longer block off the policy choices of one region on the basis of preferences at the level of a different region. Indeed, policy-wise, certain regionalisation models enable a region to opt, for instance, for rate cuts as opposed to a subsidy-based policy, whilst other regions could maintain higher rates in combination with the use of different tools of economic policy. Also, a region could individually decide to free up budget space to finance corporate tax cuts that could not be agreed upon on a federal level.

3. REGIONALISATION – 3 MODELS

Regionalisation in the area of corporate income tax can be realised through a variety of models conferring certain powers to the regions, including:

- directly allocating to the regions part of the revenue generated by the corporate income tax. This model would purely act within the limits of the Financieringswet, and could be done by increasing the regional financing envelope, or in replacement of existing financing on a different basis. While this could lead to additional financial means for the regions or alternatively, only to subject the regional budget to the volatility of corporate income tax revenue, this approach would not actually provide the region with an additional economic policy instrument. For this reason this approach is not further developed in the study in an independent manner e.g. other than as a possible or necessary add-on to the other regionalisation models;

- allowing the regions to introduce economic policy related specific tax deductions (hence impacting the taxable basis of the companies) or tax credits;

- allowing the regions to introduce discounts (and possibly up counts) on the general federal tax rate that as such remains unaffected;

- providing for a reduced basic federal income tax rate, next to which the regions may introduce their own regional tax rate.

This overview will firstly present the three different models for regionalisation that have been developed in some detail in the study. It will then take into consideration the EU issues. Finally, the overview will present the approaches that have been developed in order to make any of the three models feasible in terms of added complexity and compliance requirements. In this framework the development of a regional profit allocation formula will be discussed.

3.1. The split rate model

This model can be referred to as the “Swiss model” since it is used in its purest form in Switzerland[1].

In this model a basic federal corporate income tax rate is maintained, for instance 15 or 25% depending on the degree to which regionalisation is decided. The regions have

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[1] The German Gewerbesteuer (and add-on to the German federal income tax rate to be decided by the Länder) obviously contains many similarities with this model.

the possibility (not the obligation) to provide for their own regional rate, which is to be added to the basic federal rate in order to determine the effective total tax charge. If a region provides for a 10% rate and the federal government for a 15% rate, then the total rate is simply 25% etc…

Obviously, in view of applying the separate Brussels, Walloon and Flemish rates, the taxable income of any company with economic activities in more than one region would need to be split up over the regions. In order to avoid transfer pricing issues at the intra-Belgian level, a profit split formula is being proposed, similar to what is done in Switzerland, Germany, and Italy, and not entirely unlike what is being proposed at the EU level in the area of the European common consolidated corporate tax base.

This model is conceptually relatively simple. It fits reasonably well with the Belgian federal state set up where large part of the economic policy related powers are vested with the regions, since it clearly takes into account the corporate income tax rate as an important economic policy tool.

Logic would require that the revenue generated by the federal rate goes to the federal government and that the revenue generated by the regional rate goes to the region. As a result, changes in the corporate income tax revenue level are split over the federal government and the region. To the extent these changes result from the economic activity levels and the interest rate level[2], such impact is logical.

To the extent however that revenue changes result from changes in the rules to determine taxable income (one of the working hypotheses is that these would have remained a federal power), some protection mechanism against taxable base erosion needs to be introduced for the regions. This protection mechanism could take the form, for instance, of the required regional government approval for any new federal tax measure the calculated budget impact of which would exceed a certain threshold.

3.2. **<u>The discount model</u>:**

The discount model is a very simple model that allows the regions to introduce up to a maximum number of percent-points of rebate or discount on the general federal income tax rate. Any reduction in corporate income tax revenue resulting from the application of a discount introduced by a certain region is directly deducted from the financial means attributed to that region. In short, granting the discount is tantamount

[2] It is important to note, not only that interest increases lead to increased funding costs for companies (and hence reduced taxable income), but that the introduction of the notional interest deduction (to the extent the deductible amount would not remain a fixed one), has further increased the impact of interest rate changes on corporate income tax revenue.

to a budget outlay decided by the regional authorities which takes the form of a reduction of the corporate income tax charge.

Again, the application of this model requires that a profit split is operated, on the basis of a simple formula, in the same manner as in case of the split rate model.

One of the queries concerning this model is whether any limited reduction of the overall corporate tax rate resulting from the use of the power, would lead to a reasonable and effective cost / benefit analysis to the region. Arguably, granting specific deduction and credits is more cost effective (budget wise) to conduct an economic policy, than limited general rate reductions. Raised the foregoing issue, a substantial rat reduction (overall rate down tot 20% for instance) would be an important policy related measure, the budget cost of which might be considered too important given the difficulty to calculate the "earn back" amounts, which will in addition be spread over the federal and the regional budgets.

The insertion of this approach in the Financieringswet should not be a really difficult matter. Essentially, a region is "spending its budget" under the form of conceding tax breaks to companies.

3.3. <u>Taxable basis-model</u>:

Basically this approach would enable the regions to introduce specific tax deductions that can be considered as being an integrated part of the economic policy of the region.

In order to technically maintain a single taxable basis for the whole of Belgium, and to enable companies to continue to file one single tax return and receive one integrated tax assessment, the study has developed the concept where such tax deductions get treated for tax compliance purposes as a tax credit (equal to the amount of the theoretic deduction times the tax rate applicable in the region).

It is to be expected that such regional measures would essentially relate to investment linked or employment linked deductions or exemptions, but also the regulation regarding special amortizations or professional expenses, etc. . The system should be set up in a manner that avoids that the other regions and the federal government could, as a rule, contest regional measures on the basis that these would not fit within the scope of the economic policy powers of the regions[3].

[3] A similar procedure was launched when the Flemish Government first attempted to use its present power to grant discounts on the personal income tax levy.

Specific corporate income tax features that are based on EU harmonisation, or that are related to corporate restructurings etc. should not be open for regional measures. As such, the entire system of the dividend received deduction, tax treatment of mergers and liquidations etc. should remain federal.

Whether the notional interest deduction could be regionalised, remains to be seen. Since such deduction is based on the net asset value of the company, and hence is closely attached to the liabilities side of the balance sheet of a company, regionalising this deduction may make less sense.

Technically, this model will require that the automatic link between the personal income tax deductions relating to professional income, and the rules relating to the taxable income for corporate income tax purposes, should be abolished.

4 MEETING THE EU REQUIREMENTS

4.1. General framework

A possible regionalisation of the corporate income tax has to be in line with European law and more in particular with the “state aid” or “regional aid” prohibition. Based on previous cases concerning regional aid and the possibility for regions to introduce deviations from existing national or federal rules (for example the Italian case C-66/02 and the Portuguese case C-88/03), and on the European Commission’s policy in its decisions, it becomes possible to determine with a reasonable degree of certainty the reaction of the European Commission on the different regionalisation models. Direct contacts with the relevant division at the level of he EU Commission have taken place on these issues.

4.2. Analysis of the Court’s case law

4.2.1. Article 87(1) EC prohibits regionally selective state aid. In order to determine whether a measure is selective, it must be examined whether, within the context of a particular legal system, that measure constitutes an advantage for certain undertakings compared to others which are in a comparable legal and factual situation. The determination of such a reference framework has a particular importance in the case of tax measures, since the very existence of an advantage may be established only when compared with ‘normal’ taxation. The ‘normal’ tax rate is the rate in force in the geographical area constituting the reference framework.

3.2.2. In relation thereto the Court has decided that the reference framework does not necessarily need to be defined within the limits of the concerned member state, so that

a measure conferring an advantage in only one part of the national territory is not selective on that ground alone for the purposes of article 87(1) EC.

4.2.3. Further, the Court has already pointed out that it is possible that a region enjoys a legal and factual status which makes it sufficiently autonomous in relation to the central government of a member state, so that, by the measures adopted, it is that entity and not the central government which plays a fundamental role in the definition of the political and economical environment in which the undertakings operate. In such a case it is the area in which the region responsible for the measures exercises its powers, and not the country as a whole, that constitutes the relevant context for the assessment of whether a measure adopted by such an regional authority favours certain undertakings compared to others in a comparable legal and factual situation, having regard to the objective pursued by the measure or the concerned legal system.

4.2.4. In order to determine the selectivity of a measure adopted by a region it must be examined whether that measure was adopted by that entity in the exercise of powers which are sufficiently autonomous vis-à-vis the central power. The Court identifies three situations in this perspective.

a) In a first situation, the central government unilaterally decides that the applicable national tax rate should be reduced within a defined geographic area.

This is without discussion generally prohibited selective regional aid.

b) The second situation corresponds to a model for distribution of tax competences in which all the local authorities at the same level (regions, districts and others) have the autonomous power to decide, within the limit of the powers conferred to them, the tax rate applicable in the territory within their competence.

This situation offers possibilities to set up an EU accepted regionalisation schemes based on exclusive and competing powers for the regions. This is the case of the *symmetric devolution of competences*, discussed below.

c) In the third situation, a regional or local authority adopts, in the exercise of sufficiently autonomous powers in relation to the central power, a tax rate lower than the national rate and which is applicable only to undertakings present in the territory within its competence.

This situation covers in the first place cases where one or some regional authorities get such powers. This situation will be examined by the Court more carefully but it is not prima facie forbidden. The Court allows a regulation whereby one or several regional authorities obtain such competences as long as the conditions set out by the Court are met.

This is the case of the *non-symmetric devolution of competences*, also discussed below.

The previous considerations lead to the conclusions reported in the following paragraph.

4.3. Symmetric devolution of competences

4.3.1. The regionalisation of the corporate income tax should be acceptable at a European level if it leads to a symmetric devolution of competences towards the regions. The Court declares that a distribution of tax competences, where all the local authorities at the same level (like the three regions in Belgium) within the scope of their competences can determine a *tax rate*, can not be considered as 'regionally selective'.

4.3.2. As a consequence, a regionalisation which is feasible at European level is one that establishes:

- a regional competence concerning the ***tax rate*** taking the form of:

    - an exclusive competence for the determination of the tax rate; or

    - a parallel competence with the federal government to determine the tax rate

- a regional competence regarding certain ***deductions and exemptions***.

In conclusion, both the split rate and the rate discount models, as well as the taxable basis model, can readily be construed in a manner consistent with the EU requirements, provided symmetrical powers are attributed to each of the regions. It is important to note, that in the Belgian federal framework, such symmetrical power devolution is the only approach that appears to be possible or feasible in any event. In that case, no further special requirements (relating to the degree of autonomy of the regions) need to be complied with.

4.4. Non-symmetric devolution of competences

Whenever a specific region would have the power to introduce deviating tax rates or deviating rules concerning the establishment of taxable income, the EU Court will be much more careful and has established a very clear approach in order to establish whether a certain regime is to be qualified as 'prohibited regional aid' or not. Such approach is acceptable from an EU perspective only if it complies with the 'triple autonomy' condition.

To consider a decision taken in such circumstances as being adopted in the exercise of sufficiently autonomous powers, such decision:

a) Firstly, must have been taken by a regional authority which has, from a constitutional point of view, a political and administrative status separate from that of the central government. → ***Institutional autonomy***

The regional parliaments in Belgium meet this condition.

b) Secondly, must have been adopted without the central government being able to directly intervene as regards its content. → ***Procedural autonomy***

Also here the presence and working of the Flemish, Brussels and Walloon Parliament offer enough guarantees. The fact that regional Decrees have within the scope of regional powers an equal force as federal laws (and that federal laws can never have an impact in areas that need to be governed by regional decrees) is very important in this respect.

c) Finally, the financial consequences of a reduction of the national tax rate for undertakings in the region must not be offset by aid or subsidies from other regions or central government. → ***Economic autonomy***

The consequence of this third condition is that any budgetary impact of a regional measure should solely and entirely be supported by the regional budget.

But in addition, it would be necessary that there is a complete absence of any direct or indirect federal government support to the budget of the region. Because "money is fungible", any support given by the federal authorities to the region could be seen as indirectly helping to finance the budget cost of a tax reduction.

It is to be expected that the EU Commission may be taking a very demanding view with respect to this requirement. If a potential regional deficit or debt were to receive the guarantee of the federal government, the existence of a sufficient degree of economic autonomy might be questioned. As a result, it is to be expected that a sufficient degree of economic autonomy might be very difficult to reach in practice.

4.5. Conclusion

The regionalisation models are in accordance with European law as they include a *strict symmetric allocation of competences* towards the regions.

5. MINIMIZING THE COMPLIANCE COST AND AVOIDING COMPANY MIGRATION: THE PROFIT SPLIT FORMULA

The regionalisation of the corporate income tax would grant an additional economic policy tool to the regions, which can be used by them in a manner that reflects potential or actual differences in view between how an economic policy should be conducted. Reference can be made to Flemish government studies which would indicate the greater effectiveness of tax rate cuts as opposed to the granting of subsidies.

Such enhanced policy making possibility should not come at the expense of certain regions, and should not come at too high a cost to the Belgian companies.

5.1. It is obvious that granting the corporate tax rate tool to the regions should not come at the expense of specific regions. In that respect the position of the Brussels region is somewhat particular. A relevant number of larger companies have their effective seat in Brussels, and have in addition major investments in plants, factories and equipment (and labour) in the Walloon or Flemish region.

If the regional tax measures were to be applied on the basis of where the actual seat of the company is located, this would have a double negative consequence:

- first of all, the impact of any Brussels region measure would be disproportionate. It would be quasi impossible for the Brussels region to grant the slightest tax reduction, if such reduction would be applicable to the full (Belgian) taxable income of these large companies who have their seat in Brussels.

- in addition, it is to be noted that within Belgium, a company can change its seat relatively easily and at no particular tax cost. Hence, making the application of regional measures dependent on the localisation of the seat of a company would lead to a considerable risk that the seat of many Belgian companies would be moved to the region with the lowest tax rate. Again this would make the budget cost of a tax reduction difficult to bear for that specific region. In addition, this would imply that the budget of such region would carry the cost also of investments made in other regions.

As a result, the only approach that is feasible is to ignore the localization of the company seat, and to look at where the actual economic activity of the company takes place.

Wherever a company has its seat, the Flemish rules should be applicable to the part of its profit that can reasonably be attributed to the Flemish region, etc.. This element is key to developing a workable approach.

5.2. The compliance cost for companies should be minimized. As a result, companies should not be requested to operate a detailed profit split between the three regions (which profit would involve interest charge allocation, and hence allocation of net equity etc.).

The apportionment of Belgian profit over the three regions on the basis of a relatively simple profit split formula, has been developed in the framework of the study as an essential part of both the split rate model and the rate discount model.

The Swiss system of a split rate corporate income tax, the German system of the Gewerbesteuer introduced by the Länder and the Italian system of regional rebates on the business operations tax (the 'IRAP': L'imposita regionale sulle attività produttive), are also based on the application of a relatively simple profit split formula. The formula proposed below takes into account the lessons and experience gained in these countries applying such a formula.

5.3. It is clear to more than 98% of the companies, which are economically active in one region only, that the profit split is not an issue as their entire income will be located in (and have to be attributed to) only one region.

5.4. The basis for a formula should no doubt be a combination of employment levels and investment in real estate and other fixed assets. Such combination can most adequately reflect the level of economic activity in a given region, without being open for purely tax driven manipulation.

The employment level should be used in the formula through the total salary cost of a company in a given region. To that effect, the place out of which an employee is effectively working (which is in most cases specified in his employment contract) can be used as attachment factor. The salary cost of employees that can not be specifically attached to one region will have to be split in proportion to the salary cost of the employees that can be allocated.

The real estate investment level can readily be ascertained on the basis of the "kadastraal inkomen" of the investments held in each region.

The other fixed assets will have to be listed, and as a rule their physical location should be easy to establish. Again, a proportional rule should apply to those assets that can not be readily localised.

One useful formula would be the following:

Region A income = x% of Belgian income

X = ½ of region A salary cost/Belgian salary cost

+ ¼ of region A kadastr. inkomen/Belgian kadastraal inkomen

+ ¼ of region A fixed assets/ Belgian fixed assets)

It is to be noted that, in a rate discount model, the budget cost of a regional rate reduction will become more important the larger is the part of the income allocated to a region. Hence the regions do not necessarily have a reason to try to impose a formula that would from the outset maximize their region's share in the taxable income of the "multi-regional" companies.

An additional feature might be to allow certain companies to actually proceed with a regional split of their turnover. This should only be allowed if, based on the nature of the product or service, such income split can be readily determined without many transfer pricing or transaction allocation issues. In that case the turnover split would be taken into account for ¼ in the formula (which would cause the salary cost factor to be reduced to ¼ as well).

It should not be excluded to allow certain sectors of industry to negotiate their own sector wide applicable profit allocation formula. This may for example be useful for the banking and insurance sector. The fiscal ruling commission could no doubt play an important role with respect to requests for deviating split formula.

6. INSERTION IN THE FINANCIERINGSWET

6.1. The first point of attention when inserting a regionalisation of corporate income taxes in the Financieringswet, is to ascertain that there are no immediate jumps in tax revenue for any of the regions.

As a result, some transition phase will most likely need to be observed, and the starting point should be that the expected total budget available to the Region under an unchanged Financieringswet should on day one be equal to the expected total budget available to the region taking into account the day one effects of the regionalisation. Going forward, changes in rules that re applicable regionally will obviously affect the budget available to the region.

6.2. As mentioned above, the insertion of a rate discount model into the text and the functioning of the Financieringswet does not cause particular issues. Indeed, the revenue reductions caused at the federal level resulting from the regional discount (easily calculated as the discount percentage times the aggregate of the region's profits to which the rate reduction has been applied), will be deducted from the financing entitlement ("dotatie") of the region under the Financieringswet.

A transitional period will need to be worked out because the companies will start taking into account the rate reduction in the tax prepayments in the course of the first year where these are applicable.

6.3. Similar considerations would apply with respect to a tax base model.

6.4. A split rate model would require a more comprehensive change to the Financieringswet. Logic would imply that the regional financing entitlement would be reduced by an amount equal to the rate difference between the existing federal income tax rate before introduction of the split rate, and the new federal rate after the introduction of the regime; this rate differential should then be multiplied by the aggregate tax basis to be allocated to a specific region. It will hence be up to the region to fully compensate this amount by introducing a regional rate equal to such difference (leading to no reduction at all in the total rate), or to introduce a lower rate and hence support a budget cost.

In this case, a “dry run” year should probably be provided for, allowing the authorities to gain sufficient information prior to the actual application of the system, in order to be able to initiate a reasonably correct impact on the regional financing from the first year (the year where the tax prepayments are being affected).

Also, in this case it should be determined to what extent the impact on the regional budget would be stabilised, and remain a function of the first year correction (amended over time on the basis of parameters). The more logical approach would be however to accept that all increases and decreases in corporate income tax revenue, resulting from whichever cause, fully impact the regional budget.

Such changes are essentially caused by the economic activity levels and by the interest rate level.

It would be reasonable to provide a mechanism whereby the regions would have the possibility to question changes in the rules relating to the tax base, decided at the federal level, that are expected to have a budget impact exceeding a certain threshold. It should indeed be avoided that the federal level be able to either materially reduce the taxable income, or on the other hand cause considerable tax increases by changing the manner in which the taxable income is being determined.

7. SOME OBSERVATIONS RELATING TO PERSONAL INCOME TAXES

7.1. The regionalisation of personal income tax powers can again take the form of either the power to determine certain deductions or credits (namely those that are in line with regionalised powers or powers granted to the communities) or the power to amend rates.

7.2. In case the power to set rates is regionalised (but also to some extent if the deduction would be regionalised) one of the points of attention is whether an individual taxpayer would be subject to the full set of rules of his/her region of residence, or whether the rates and rules o the region where employment takes place (if this would happen to be a different region), should be applied.

The issue is of essential importance to the Brussels region where a considerable number of taxpayers earn their salaries, whilst living, with their family, in the Flemish or Walloon region.

For a number of reasons the approach where the rates and rules of the "region of residence" are applied, should be preferred.

7.3. In international tax law, and under the OECD double tax treaty rules, a situation most comparable to the Brussels region situation also leads to full taxation solely in the state of residence.

Indeed, whilst to an important extent the international (OECD) rules are granting the power to tax to a state where the employment of the resident of a different state occurs, the Brussels situation should be compared to the situation of the so-called "frontier workers" which refers to those individuals travelling to the neighbouring country on a daily basis just for professional reasons. With all neighbouring countries, a "frontier workers" regime has been developed under which all of the income, including the salary earned when spending the working hours of the day in the neighbouring country, are fully and solely taxed in the state of residence.

7.4. Taxation by the "region of working place" leads to granting to the (Brussels) region(s) a taxable basis that is highly elastic in that migration of working places towards the region around Brussels is, within a single country, easy to realise. One could wonder for instance what the reaction of the Flemish authorities would be if the personal income tax regionalisation would lead to paying over a substantial part of the salaries paid to Flemish government employees (which comes out of the Flemish budget) to the Brussels region… The Walloon regional authorities would not have this issue because the Walloon administration has for the larger part already been transferred out of the Brussels region.

7.5. In case the regions (communities) would have the power to decide a series of deductions and credits, these would be related to a series of competencies of the region that are most logically relating to the place of residence of a taxpayer (schooling, housing, cultural development, sports, health etc…).

8. CONCLUSION

The elements presented in this paper could be viewed as leading to the following findings.

8.1. Regionalisation of corporate income taxes would make available to the regions the tax policy tool that fits more readily the regional (existing) competence of economic policy.

8.2. None of the technical arguments against regionalization can be maintained if the regionalization model is developed along the lines presented in this paper. Also the intra-regional tax competition argument against regionalization is hardly convincing taking into account today's inter-regional competition based on the granting of subsidies. In short, regionalization of corporate income taxes using one of the models that have been developed, is workable, feasible, acceptable to the EU authorities and does not lead to major compliance issues for the multi-regional companies. There is no risk of inter-regional company migration, nor of introducing inter-regional transfer pricing issues.

8.3. Regionalising the power to set certain economic policy related tax deductions and tax credits is an approach that certainly needs to be considered.

8.4. Regionalising powers relating to tax rates can be envisaged. in that case the "swiss model" would fit best with the Belgian concept of a (con)federal state.

8.5. When introducing the regionalization of corporate income taxes in the Finance Law, care should be taken (through a transitional, or even "dry run", interval) that the regional budgets would not undergo changes merely as a result of introducing the regionalization mechanism.

8.6. The political choices whether to regionalize, and to what extent and how to regionalize corporate income taxes, are open.