Neutrality as Tax Justice: The Case of Common Consolidated Corporate Tax Base under the EU law*

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Summary: The tax neutrality principle was defined as a tax system not influencing the taxpayers' business decisions. Economists usually use 'the no tax world' as the baseline to decide if a specific tax measure is 'neutral. If a taxpayer's reaction to a specific tax is the same as if there is no such tax, then it is neutral. Such formulation of tax neutrality is inappropriate to evaluate taxation in a regional market as European Union. This paper establishes a new normative framework for evaluating the EU corporate tax law reform project, the Common Consolidated Corporate Tax Base (CCCTB) Proposal, that aims to properly tax MNE taxpayers' cross-border income by a pre-decided formula. The tax neutrality principle should be not be based on the no-tax baseline but interpreted as 'faithfully reflecting the taxpayers' economic activities throughout EU'. EU Member States should maintain proper fiscal autonomy to decide their actual administration inputs (the public benefit provided) and their own method to implement the EU level corporate group taxation (the subsidiarity principle). This trio-formulated neutrality concept falls between Rawls' liberalism theory and Nozick's libertarianism theory, closer to Liam Murphy and Thomas Nagel's tax justice theory. Such trio-combination also better regulates the interactions of the three actors in the EU internal market: EU, Member States and MNE taxpayers. This reformed neutrality is a more appropriate norm than one single economic or legal principle for the EU corporate tax reform.

Keywords: European Union – Common Consolidated Corporate Tax Base (CCCTB) – the tax neutrality – the benefit principle – liberalism – libertarianism – the subsidiarity principle – Formulary Apportionment – tax justice

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1. Introduction

What criterion is desirable to evaluate a corporate taxation system, especially in the context of regional integration, such as European Union, is a difficult puzzle. The puzzling points are multiple-folded. First, a corporate income tax system itself as such is disputed for resulting in economic double taxation to shareholders. Corporations can conduct economic activities much more extensively than individuals, but they are legal fictions and still owned and managed by natural persons. It has been long argued that corporate income tax is redundant or unnecessary double taxation in relation to shareholders' personal income tax. Second, in the European Union context, corporate income tax is the sensitive area and is rarely harmonized. Member States' fiscal autonomy on corporate tax is still quite extensive, even subject to the internal market mandate. The consequence of maintaining such fiscal autonomy is tricky: on the one hand, Member States compete with each other to attract corporations' economic activities and capital into their jurisdictions so there is a concern of 'racing to the bottom'; on the other hand, disparities of national tax laws have resulted in enormous compliance costs and provided aggressive tax planning opportunities for multinational enterprises (MNEs). OECD's Base Erosion and Profit Shifting (BEPS) project has revealed many problems caused by MNEs. Third, corporate income tax on MNEs' cross-border economic activities, will directly involve allocating taxing powers between Member States. In other words, EU tax law will have to deal with the relation between EU and its Member States; the relation between MNE taxpayers and involved Member States; and the relation between Member States with each other.

To seek a desirable normative framework to evaluate a corporate taxation system under the EU law, a reformed framework or principle would be needed. This is why I decide to review critically one of the most accepted[1] norms for the tax law and policy: 'tax neutrality'. Tax neutrality has been discussed widely in the context of international tax law and policy as well as EU tax harmonization. Since the mid-20th century, Economists and tax academics have developed various different meanings of neutrality: Capital Export Neutrality (CEN), Capital Import Neutrality (CIN), Capital Ownership Neutrality (CON), Market Neutrality (MN). Each type of 'neutrality' represents a specific policy goal, and therefore there is no hierarchy between them. When it comes to corporate group taxation at EU level, i.e. CCCTB, it has been argued that CEN, CIN and MN should all be achieved at the same time. In this regard, it is not crystal clear how and what

[1] WEISBACH, D. A The Use of Neutralities in International Tax Policy, University of Chicago Coase-Sandor Institute for Law & Economics Research Paper No. 697 (2014) [online]. Available at: http://ssrn.com/abstract=2482624, accessed 14 March 2019.

'neutrality' should be as the normative framework to design a fair tax formulary apportionment system for EU and Member States.

The research question of this paper is: what does and should neutrality mean to the Common Consolidated Corporate Tax Base (CCCTB) under the EU tax law and how political philosophical ideas of 'justice' evaluate CCCTB and lead to similar or different policy options. In the field of tax law and policy, economics have played an active role as the analytical tool, whereas the political philosophy has not influenced quite much. When it comes to ideas such as 'justice' or 'legitimacy' or 'fairness', the design of a tax policy or system can be comprehensively and convincing when we also incorporate the discipline of philosophy.[2] Therefore I also explore the justice ideas developed by representative political philosophers and focus on these philosophers' (possible) responses to the options of the CCCTB Directive.

This paper is structured as follows. Section 2 discusses the different definition of 'neutrality' in the different contexts and the neutrality derived from the CCCTB Directive Proposal. There are quite a few neutrality principles and each principle is related to a specific policy goal, including capital import, capital export, capital ownership or market participants' competition; in many cases, neutrality is the synonym of non-discrimination, such as the 'fiscal neutrality' in the VAT discussions. It seems that none of these formulations can demonstrate the neutrality norm that pursued by EU harmonization on direct taxation. Under the discussion of establishing an EU internal market, the tax neutrality principle should not only be understood as pursuing the goal of efficiency but also taking into account the subsidiarity principle and the benefits principle. The Common Consolidated Corporate Tax Base (CCCTB) Proposal is an example that the neutrality principle should be understood broadly as 'not causing distortions to taxpayers' economic decisions' and 'reflecting economic reality'. CCCTB has a broad scope of harmonization in order to pursue a more integrated internal market, and at the same time it also aims to tax multinationals' pan-EU cross-border activities in a predictable and less manipulative manner; CCCTB is also expected to allocate Member States' taxing powers fairly. Such tax neutrality principle under CCCTB, is not limited to any international tax neutrality principle in the narrow-sense, and it is inevitably overlapping with inter-nation equity.

Section 3 will discuss justice ideas of three schools of thoughts: John Rawls' liberalism and Nozick's libertarianism and Liam Murphy& Thomas Nagel's tax justice theory and examine CCCTB against these theories. Generally speaking, these three schools of thoughts all justify adopting CCCTB. The neutrality that

[2] The research approach of this paper is inspired by two books: MURPHY, L., NAGEL, T. *The Myth of Ownership: Taxes and Justice*. Oxford: Oxford University Press, 2002, p. 1–228; BHANDARI, M. (ed.). *Philosophical Foundations of Tax Law*, 2017, Oxford: Oxford University Press, p.1–320.

CCCTB pursues, however, falls between Nozick and Rawls and also matches Murphy& Nagel's idea.

Section 4 further discusses two specific policy options that CCCTB chooses: un-harmonized tax rate/free tax rate competition and the three-factor sharing formula. In the specific option level, these three schools of thoughts would lead to different choices. I will explain these differences and argue that, a broad definition of the neutrality principle that uses the well-maintained market environment as the baseline (not the no-tax world), will support the healthy tax rate competition and the sharing formula consisting of production and customers' market side of the market. Section 5 concludes that, abroad-sense neutrality is necessary for EU corporate tax law, and it falls between the schools of liberalism and libertarianism as it might be close to the tax justice in Murphy& Nagel's idea, though Murphy& Nagel's has excluded corporation tax and international tax from their discussions. There is still an unsolved puzzle regarding the tax incidence (i.e. the actual tax burden) but it should be ancillary.

2. The Tax Neutrality Principle Revisited

2.1. The Varied Meaning Of The "Neutrality" Norm

In the development of international tax law, the prominent economist Musgrave proposed the concept 'neutrality' as a norm, and he distinguishes two types of "neutrality": the capital import neutrality (CIN) and capital export neutrality (CEN).[3] The neutrality principle mandates that the ideal relation should be between taxation-imposing sovereign states and capital flow of private businesses, as taxpayers. Therefore, in this context the neutrality principle is a negative norm for sates: the effect of taxation should 'not' discourage taxpayers from conducting capital import (i.e. inbound investment) under the capital import neutrality principle; taxation should not discourage taxpayers from conducting capital export (i.e. outbound investment). The baseline to decide whether a taxation system is neutral is to compare with the situation as if there is no-tax levied.[4]

[3] Two aspects of neutrality see MUSGRAVE, R. A. Criteria for Foreign Tax Credit. In: Baker, R. *Taxation and Operations Abroad*. Princeton: Tax Institute, 1960, p. 83–93. Later Peggy Musgrave also further writes about the distinction of CEN and CIN. See MUSGRAVE, P. B. *Taxation of Foreign Investment Income, An Economic Analysis*. Johns Hopkins Press, 1963, p.1–140, reprinted in MUSGRAVE, P. R. *Tax Policy in the Global Economy: Selected Essays of Peggy R. Musgrave*, Cheltenham: Edward Elgar, 2002, p. 1–470.

[4] The no-tax as the base line is widely accepted by a lot of scholars, such as SHAHEEN, F. International Tax Neutrality: Reconsiderations. *Virginia Tax Review*, 2007, vol. 27, no. 1, p. 203–239.

Peggy Musgrave clearly has the preference of CEN over CIN, because she sees conducting outbound investment as a measure to maximize the global welfare. Musgrave's neutrality principle has become a well-accepted norm to evaluate international tax policies and laws. Both CEN and CIN are adopted by different states, out of different policy concerns. Some states have the policy of encouraging outbound investment whereas some states have the policy of encouraging inbound investment. Conceptually speaking, CEN and CIN are mutual exclusive and cannot be achieved simultaneously, unless different sovereign states decide to have the identical tax rate.[5] This conclusion is actually quite obvious, because CEN and CIN describe the different demands for the state: to encourage inbound or outbound investment. CEN and CIN are 'mirror images'[6] to each other; they are interrelated but describe two opposite demands.

Later on, other economists also developed other broader neutrality concepts, such as market neutrality (MN), which demands that taxation should let the individual participants to compete freely in the market.[7] Capital Ownership Neutrality (CON), which is derived from CIN, also developed. MN addresses a tax system not hindering market participants' competition and CON focuses on the effect of a tax system on capital owners.[8]

These different neutrality principles do not have hierarchy or superiority, but merely describe different policy directions. What these neutrality principles are in common is that 'neutrality' should be read as the synonym of 'not negatively influence', and the concept 'neutrality' has to be combined with an item that should not be negatively influenced by taxation. In other words, the neutrality concept in these principles all refers to a narrow meaning, not a broad one.[9] We

5 Different opinion, see Id. Shaheen argues that CEN and CIN can be achieved simultaneously even when the tax systems of different sovereign states are not uniformed, as long as the demand of CIN is interpreted as capital ownership neutrality, which demands the tax law not to negatively influence capital ownership by domestic or foreign owners. For example, Knoll disagrees with him and argues that the terminology of CEN and CIN should be re-considered, see KNOLL, M. S. Reconsidering International Tax Neutrality, *Tax Law Review*, 2011, vol. 64, no. 2, p. 99–129.

6 Maarten de Wilde, *Sharing the Pie: Taxing Multinationals in a Global Market* (IBFD 2017) at 3.2.4.4.

7 This concept of MN is developed and elaborated by Michael P. Devereux, see DEVEREUX, M. P., LORETZ, S. *Evaluating Neutrality Properties of Corporate Tax Reforms, Oxford University Centre for Business Taxation Working Papers no. 1007 (2010).* [online]. Available at: https://EconPapers.repec.org/RePEc:btx:wpaper:1007, accessed 25 March 2019. They argue that, the CCCTB proposal could move toward CEN or MN, but adoption of such formulary apportionment system while maintaining the differential tax rates, can introduce new distortions and thus still deviate from MN.

8 Capital Ownership Neutrality explanations, see HINES, J. R. Jr. Reconsidering the Taxation of Foreign Income. *Tax Law Review*, 2009, vol. 62, no. 2, p. 269–298.

9 Weisbach observes the variety of 'neutrality' principles and indicates that each neutrality concept represents a different policy objective. He also argues that these neutralities (in the narrow sense) are not useful to establish the criterion of 'optimal tax'. See Weisbach (n1).

can also see the similar pattern in the non-discrimination principle: the non-discrimination principle needs to be embodied by including a 'non-discrimination ground' such as nationality, gender, race, etc. The neutrality principle in the economic literature also has to be combined with a 'neutrality ground', such as capital import, capital export, capital ownership market competition, etc. Therefore it is quite interesting to show that, these neutrality principles are not 'neutral' themselves, because each of them has a distinct policy direction. Not negatively influencing 'capital export' will inevitably influence 'capital import'; and thus a pure neutrality principle does not seem to exist in these discussions. Rothbard even proactively argues that neutral taxation is really a **myth**, and it is just like the case that it is impossible to claim 'money' is neutral.[10] From formulations of these tax scholars, the terminology of 'neutrality' has multiple meanings in each different context. When we need to use the neutrality principle as the norm to evaluate a large-scale tax policy which covers more than one objective, it would be wise to take a broader definition, not a narrow one.[11]

In the context of EU tax law development, the neutrality principle has different meanings. We can see such variety in the primary law level, the secondary law level and Court of Justice's jurisprudence. In the primary law, the neutrality principle, not being mentioned directly but well-recognized by prominent EU tax law experts, can be derived from EU's purpose of pursuing economic efficiency and establishing the internal market.[12] The rationale of the neutrality principle in the internal market is that, Member States' legislation (as well as EU harmonization), should pursue the market economy and its efficiency, and so EU law, including tax law, should eliminate distortions in the internal market and not to give rise to distortions either. Pre-existing distortions might result from disparities of national law and thus eliminating such distortions would require harmonization. When adopting a new piece of EU law, it should be cautious not to create distortions to make the internal market 'not neutral'.

As to the secondary law, either Directives on direct taxation or indirect taxation can provide a comprehensive idea of 'neutrality'. There are only few Directives harmonizing direct taxation. Among these Directives regarding direct taxation, CEN and CIN are both accepted and sometimes co-exist as equal options. For example, Parent

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10 ROTHBARD, M. N. The Myth of Neutral Taxation. *Cato Journal*, 1981, vol. 1, no. 2, p. 519–564.

11 Kahn also observes the two meanings of 'tax neutrality' co-exist but should both be re-considered. He argues that, the narrow meaning of tax neutrality that is against a specific bias due to the tax law might not be very useful to have a picture of 'the ideal tax system'. See KAHN, D. A. The Two Faces of Tax Neutrality: Do They Interact or are They Mutually Exclusive? *Northern Kentucky Law Review*, 1990, vol. 18, no. 1, p. 1–18.

12 See discussions on neutrality derived from TFEU Article 110 and Article 120, SCHÖN, W. Neutrality and Territoriality – Competing or Converging Concepts in European Tax Law? *Bulletin for International Taxation*, 2015, Vol. 69, no. 4/5, p. 271–293.

Subsidiary Directive allows Member States to choose the exemption method or the deduction method to implement the Directive, so both CEN and CIN are acceptable.[13]

In the filed of VAT of EU law, VAT fiscal neutrality has another different meaning: it is synonym of non-discrimination. The normative content of the fiscal neutrality of EU VAT rules, refers to two sub-concepts: (1) VAT should be neutral for competition of similar goods and services; (2) VAT levied upon similar goods and similar services should not be different whatever the length of he production and distribution chain.Fiscal neutrality in VAT especially focuses on ensuring non-discrimination between similar goods and services.[14]

Jurisprudence of Court of Justice of European Union (CJEU) does not provide a more clear idea regarding tax neutrality either. Court of Justice of European Union seems to have an ambition to pursue both CEN and CIN under the EU law[15], though sometimes the Court randomly turns down CIN or CEN in difference cases.[16] To achieve both CEN and CIN might look illogical, because CEN and CIN are two distinctive demands and it is impossible to eliminate all the disparities of Member States' tax laws. However, if we step back to the fundamental purpose of 'establishing' an internal market in European Union, inbound and outbound flow of trade and capital, are equally important. Four fundamental economic freedoms under the EU law encourage cross-border activities 'between' Member States, and thus the distinction between CEN and CIN will naturally disappear, because EU law aims to create an internal market. In this regard, a broader sense of neutrality that can encompass both CEN and CIN, will be necessary for evaluating EU tax law and policy, though the jurisprudence of the Court of Justice European Union does not contribute much to the substantial contents of the neutrality principle.[17]

Being different from economists who create different 'types' of neutrality, legal scholars have argued that the concept tax neutrality has to be reformed especially for evaluating EU law. For example, Vogel has analyzed that tax neutrality should not be limited to capital import or capital export, but should be interpreted as taxation should not alter the business decisions and should not cause distortions. He described this as 'cross-border neutrality'.[18] As another example,

[13] CERIONI, L. The *European Union and Direct Taxation: A Solution for a Difficult Relationship*. 2015, New York: Routledge, p. 1–254, at p. 56.

[14] See the general introduction of the concept of VAT neutrality, HERBAIN, A. H. *VAT Neutrality*. Cork: Primento Digital Publishing, 2015, p. 1–235; DE LA FERIA, R. *The EU VAT System and the Internal Market*. Amsterdam: IBFD, 2009, p. 1–382, Ch. 4; OECD VAT/GST Guidelines, 2017.

[15] DE WILDE, M. *Sharing the Pie: Taxing Multinationals in a Global Market.* Amsterdam: IBFD 2017, p.1–798, at 3.2.2.4, (IBFD 2017).

[16] Ibid., a comparison of CJEU's inconsistent case law on CEN and CIN at 3.2.4.3.

[17] Ibid., at 3.2.4.3 (IBFD 2017).

[18] Klaus Vogel used 'cross-border neutrality' to describe this status. See VOGEL, K. *Taxation of Cross-border Income, Harmonization, and Tax Neutrality Under European Community Law: An Institutional Approach*. Alphen aan de Rijn: Kluwer, 1994, p. 1–50.

Smit also adopts a broader definition: neutrality under EU tax law should mean 'being absent from company tax distortions and business decisions are based on economic conditions, not on tax law conditions.[19] In the context of EU corporate tax law, their concepts of neutrality are more general than traditional concepts of CEN, CIN or MN. At the end of the day, economists also evaluate a piece of legislative proposal by taking into account different types of neutrality principles at the same time,[20] and legal scholars aim to reform the normative content of the neutrality principle.

In addition to pursuing economic efficiency in the market, other fundamental principles of EU law, will also play a role to formulate the idea of neutrality. European Union has the fundamental purpose to establish an internal market as if there are no borders or obstacles. Member States will implement the creation and integration process of EU internal market altogether, but Member States should not give up their diversity completely. EU law has long recognized 'subsidiarity principle' that regulates the issues that Member States and EU share legislative competence. The internal market is the shared competence of EU and Member States, and therefore all EU legislation regarding the internal market, should comply with the subsidiarity principle. The subsidiarity principle requires that an issue should be left to Member States to decide in case it is still more efficient for Member States to implement. It is EU that bears the burden of proof to show that the EU harmonization measure is really necessary (the EU added-value test) and proportional (i.e. in the least intrusive way, the proportionality test).[21] In other words, a EU harmonization measure that aims to eliminate completely the disparities is not allowed not only from the perspective of political reality but also from the perspective of the general principle of EU law. If a harmonization eliminates all the diversities from EU Member States for the issues that EU Member States still enjoy competences, such harmonization would be contrary to the subsidiarity principle and thus unconstitutional under the EU law. From the procedural perspective, since 2009 EU law provides the yellow card procedure[22] for national parliaments to review and submit

[19] SMIT, D. EU *Freedoms, Non-EU Countries and Company Taxation*. Alphen aan de Rijn: Kluwer Law International, 2012, p. 1–898., Ch. 2.

[20] For example note 7, Devereux & Loretz adopt and analyze MN and CEN respectively to the CCCTB proposal discussions.

[21] There are enormous discussions on the subsidiarity principle under the EU law. In the context of discussing the subsidiarity principle regarding creating the internal market, I find Portuese' work useful because he analyzes it from the economic efficiency perspective. See PORTUESE, A. Principle of Subsidiarity as Principle of Economic Efficiency. *Columbia Journal of European Law*, 2011, vol. 17, no. 2, p. 231–262.

[22] For example. In: 2011 national parliaments have submitted their opinion about the CCCTB Directive Proposal, and negative opinions are not qualified to precede the yellow-card procedure.

their opinion on whether a specific EU legislative proposal is compatible with the subsidiarity principle. Therefore, from both the substantial and procedural perspectives, the subsidiarity principle is the fundamental principle of EU law that both Member States and EU institutions should comply with from the very beginning of the legislative process.

Last but not the least, EU tax laws also involve allocating taxing powers between Member States. Therefore, the fairness or inter-nation equity[23] between Member States is also necessary and imperative. Inter-nation equity will also play a role the meaning of neutrality. Inter-nation equity means that, the fair relationship between national gain or loss capture between two (or more nations), each of which has a connection to a particular gain.' In the field of international tax law, the core issue of inter-nation equity is how taxable income from cross-border economic activities should be taxed and how different countries involved should share such tax. The conflict between the residence taxation and the source taxation in the field of international tax law, also belongs to the discussion of inter-nation equity. EU tax harmonization has addressed the same issue, i.e. dividing taxing powers between EU Member States reasonably and fairly. Therefore, the neutrality under the EU tax law would inevitably overlap with the concept of inter-nation equity. The following section will demonstrate this overlapping by using the CCCTB Directive Proposal as an example.

2.2. The Neutrality In The Case Of The CCCTB Directive Proposal

The CCCTB Directive Proposal aims to harmonize corporate tax and the way of allocating the taxing powers of Member States. Therefore it will provide a new set of mandatory corporate tax law for MNEs taxpayers above a certain size, and replace the current bilateral tax treaties between EU Member States.

See SZUDOCZKY, R. Is the CCCTB Proposal in line with the Principle of Subsidiarity? In: Weber, D. (ed.). *CCCTB: Selected Issues,* Alphen aan de Rijn: Kluwer, 2012. As Szudoczky analyzes, the 13 negative reasoned opinions submitted by parliaments of the Member States, have a common feature: these reasoned opinions are formulated as being more similar to discuss the proportionality of the element of consolidation of CCCTB Directive Proposal, instead of arguing the two tests indicated in the impact assessment. Member States are arguing the same objectives, including eliminating compliance costs from national tax law disparities and lowering high transfer-pricing costs, should be achieved in a less intrusive way for Member States.

23 Reviews of Musgrave's idea about intra-nation equity, BROOKS, K. Inter-Nation Equity: The Development of an Important but Underappreciated International Tax Value. In: Krever, R., Head, J. G. (eds.). *Tax Reform In The 21st Century: A Volume in Memory of Richard Musgrave.* Alphen aan de Rijn: Kluwer Law International, 2009, p. 471–498.

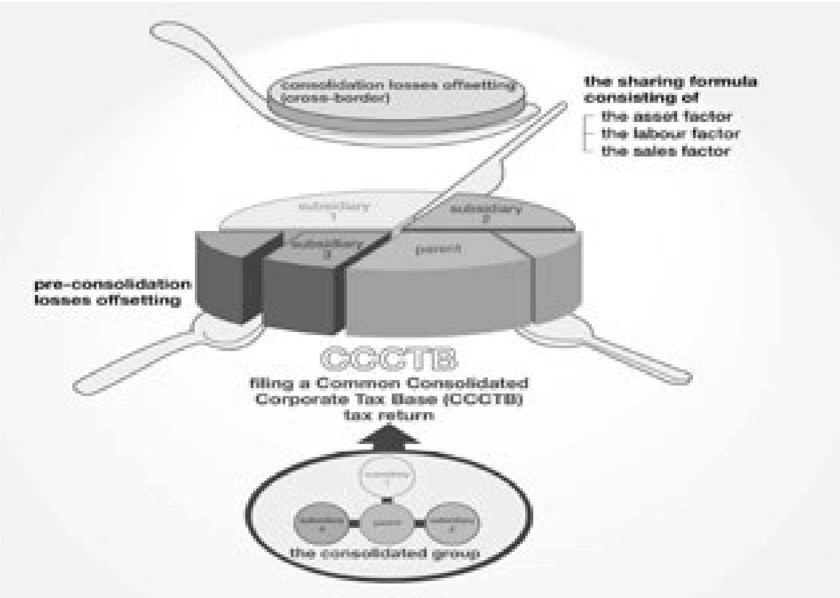
By a metaphor of 'a pie and a knife', a multinational enterprise (MNE) group active in different EU Member States can file their harmonized consolidated tax base from all qualifying group members from different EU Member States, and such consolidated tax base is like a big pie, jointly contributed by all group members; and the formula is like a knife to decide the share/a piece of the pie which is apportioned to each group member.

Therefore, each group member's apportioned share of the taxable pie of the whole group, would be calculated as:

$$\text{the consolidated tax base}\times\left(\frac{1}{3}\times\frac{\textit{the member'ssales}}{\textit{group sales}}+\frac{1}{3}\times\frac{\textit{the member's assets}}{\textit{group assets}}+\frac{1}{3}\times\frac{\textit{the member's labour}}{\textit{group labour}}\right)$$

The overview of the CCCTB is illustrated in Figure 1.

Figure 1: The Common Consolidated Corporate Tax Base Directive Overview



Source: the author

This Directive proposal uses a pre-determined “formula” to apportion taxable income of MNE taxpayers, and therefore it is abbreviated as Formulary Apportionment (FA). This legislative proposal is a tax reform effort at the EU level to provide all EU Member States a uniform consolidated (i.e. group) corporate tax base and a formula to divide their taxing powers on multinational enterprise (MNE) taxpayers’ income. It would replace the bilateral tax treaties between these EU Member States when being adopted. It should be noted that, although EU has more than 50 years history, corporate taxation is still rarely harmonized by EU legislations. When the CCCTB Directive Proposal is adopted unanimously by EU Member States, it would be a milestone also for the EU law development as a whole.

Here comes the core question: what should be the normative content of the tax neutrality principle in the CCCTB Directive?

As indicated above, different EU law instruments provide different formulations of ‘neutrality’, and it is because each instrument serves its own specific purpose and addresses a specific distortion. Therefore, since the CCCTB system is a larger-scale harmonization for corporate income tax and has two purposes at the same time (eliminating tax obstacles due to national law disparities and combating tax avoidance), will need a broad neutrality principle that covers not only CIN[24] or CEN or cross-border activities’ neutrality and ‘market/competitive’ neutrality’ between MNE taxpayers, but also achieving “inter-nation equity/fairness” between Member States in the end. To achieve this fairness, it is essential that the CCCTB Directive faithfully represent eligible taxpayers’ “economic activities” from the supply/input side (the labour and the asset) as well as the demand/output side (the sales), i.e. throughout the supply-consumption chain. A tax system that can reflect different types of economic activities conducted by MNE taxpayers can also ensure the fairness between different Member States, which have different resources and provide different public services. In other words, a neutral CCCTB system should especially be reflect and focus on ‘economic activities’, not focus on any formal qualification, which can easily deviate from the economic reality.[25]

24 Some scholar advocates CIN as the fundamental rationale for the CCCTB Directive, ANDERSSON, K. An Optional Common Consolidated Corporate Tax Base in the European Union. In: Andersson, K., Eberhartinger, E., Oxelheim, L. (eds.). *National Tax Policy in Europe: To Be or Not to Be?* Berlin: Springer, 2007, p. 86–90.

25 As to focusing on the reality instead of form in the company law, this has been long recognized by EU legislators. For example, in 1992 the European Commission’s Ruding Report on the direction of European company tax reform, also refers this as “neutrality of legal form”, to require equal treatment between subsidiaries and permanent establishment. Ruding report uses the term ‘neutrality’ also in a narrow sense. The full text of Ruding report, see the archive:

To take into account the fairness/inter-nation equity between EU Member States in the context of the EU law, the neutrality principle should incorporate the benefit principle and the subsidiarity principle. The benefit principle[26] and the subsidiarity principle are both important principles that support and reserve Member States' fiscal autonomy and diversity. The benefit principle plays an important role in the development of tax law although it does not seem to have a status the general principle of EU law. As Brooks analyzes, corporations enjoy two sets of benefits that justify levying corporate income tax: the first type of benefit for shareholders, is the legal personality and limited liability of a corporation.[27] Such legal privilege would enable shareholders to invest more freely, via a corporation. The second type of benefit is various 'legal, social, and economic infrastructure to earn profits' that that a corporation receives from the state, including health and qualified workforce, transportation and communication infrastructures, etc. Despite of theoretical objections, it is undeniable that these two types of benefits are actually enjoyed and provided to corporations in the modern market economy.

In the EU law regarding the field of personal direct taxation, the Court of Justice of European Union does not view personal direct tax as the price for a bundle of public goods, in the case *Schumacker* (Case C-279/93).[28] However, the doctrine from the case *Schumacker* does not preclude the benefit principle from applying to the corporate income tax. In fact, the Court of Justice seems to decide its cases regarding Member States' treaty laws in line with the benefit principle: the Court rejects the most favorable treatment principle applied in the field of tax law, and recognizes the disparity of withholding tax rate of different Member States. In other words, EU Member States have no obligation to adopt the minimum withholding tax rate among all Member States. As Englisch's analysis on the case law *Schumacker* demonstrates, the benefit principle is the cornerstone supporting Member States' fiscal autonomy and thus this principle is indirectly reflected in CJEU's jurisprudence.[29]

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https://publications.europa.eu/en/publication-detail/-/publication/0044caf0-58ff-4be6-bc06-be2af6610870/language-en, accessed 8 August 8 2018

26 Discussions regarding the origin of the benefit theory, see COOPER, G. The Benefit Theory of Taxation. *Australian Tax Forum,* 1994, vol. 11, no. 4, p. 397–509. A more recent discussion, see STEWART, M. *The Tax State, Benefit and Legitimacy, The Tax State, Benefit and Legitimacy, Tax and Transfer Working Paper No. 1/2015, (2015)* [online]. Available at: https://taxpolicy.crawford.anu.edu.au/publication/ttpi-working-papers/7567/tax-state-benefit-and-legitimacy

27 BROOKS, K. Learning to Live with an Imperfect Tax: A Defence of the Corporate Tax, 36, *University of British Columbia Law Review,* 2003, vol. 36, no. 3, p. 621–672.

28 Case C-279/93, Finanzamt Köln-Altstadt v Roland Schumacker, European Court Reports 1995 I-00225, ECLI identifier: ECLI:EU:C:1995:31.

29 ENGLISCH, J. Tax Coordination between Member States in the EU – Role of the ECJ. In: LANG, M. et al. (eds.). *Horizontal Tax Coordination,* Amsterdam: IBFD, 2012, p. 3–22.

The rationale of the benefit principle is clear: in order to provide public benefits, levying taxation is justified, including corporate tax.[30] In the field of international tax law, the (reformed) benefit principle justifies the allocation of a taxable income between the source state and residence state.[31]The benefits are no longer understood as a specific public service, but a more general idea as 'public goods', including education, health and even 're-distribution' can be seen as a type of 'public good'.[32] In the formulary apportionment discussions, the benefit principle is adopted as a reason to justify the sales factor, labour factor, and the asset factor, because the benefit principle also describe the 'relation' between these factors and the involved states, because these factors are the indicators of public benefits being provided.[33]

By taking into account the benefit principle, the neutrality principle will not use a 'no-tax world' as the optimal or perfect world. Instead, the tax neutrality principle for EU Member States should make the "market" functioning well, which also includes the tax levied for the costs of providing the good public services. Tax levied to provide public service that can enhance taxpayers' productivity, is not 'neutral' from the no-tax baseline; however, from the perspective of efficiency, the very origin of neutrality principle, levying tax to provide sufficient public service, is desirable and even closer to the ideal status of neutrality. For example, Hasen reconsiders[34] the presumption of no-tax baseline for the neutrality

30 The opposite argument that the benefit principle cannot justify corporate tax: see DODGE, J. M. *Does the 'New Benefit Principle' (or the 'Partnership Theory') of Income Taxation Mandate an Income Tax at Both the Individual and Corporate Levels?' FSU College of Law, Public Law Research Paper No. 118 (August 2004)*. [online]. Available at: http://dx.doi.org/10.2139/ssrn.571826

31 The benefit principle plays an important role the international tax law in the beginning of the early 20th century, see the introduction by L. J. Global Profit Split – An Evolutionary Approach to International Income Allocation. *Canadian Tax Journal,* 2002*,* vol. 50, no. 3, p. 823–883; Other scholars argue that, the benefit principle in the international tax law is actually a failure. See FLEMING, J. C., PERONI, R. J., SHAY, S. Fairness in International Taxation: The Ability-to-Pay Case for Taxing Worldwide Income. *Florida Tax Review*, 2001, vol. 5, no. 4, p. 299–354, at p. 334; More recently Avi-Yonah and Xu also argue, the current way that the benefit principle applied to international tax law is already outdated and can no longer properly allocate international active and passive income earned in a digitalized world. They argue for a reverse application of the benefit principle, i.e. active income to the source jurisdiction and passive income to the residence jurisdiction. I do not fully agree with their conclusion, but I agree with them that the benefit principle should also be reformed. See AVI-YONAH, R. S., XU, H. Evaluating BEPS: A Reconsideration of the Benefits Principle and Proposal for UN Oversight. *Harvard Business Law Review*, 2016 vol. 6 no. 2, p. 185–238.

32 See note 26, Miranda Stewart.

33 MAYER, S. *Formulary Apportionment for the Internal Market*. Amsterdam: IBFD, 2009, p.1–354, p. 21.

34 HASEN, D. M. Tax Neutrality and Tax Amenities. *Florida Tax Review*, 2012, vol. 12, no. 2, p. 57–125.

principle, but opts to the baseline which takes into account the taxation covering public revenues.[35] Another scholar, Knoll also casts doubts on this presumption of no-tax "ideal" world. To pursue the fairness and the benefit principle between EU Member States via a large-scale harmonization as CCCTB, the no-tax world should not be the hypothetically perfect world or the base line.

As to evaluate the boundary between EU and Member States' competence, the subsidiarity principle plays an essential role, when we formulate tax neutrality under the EU law for evaluating the CCCTB Directive. As Portuese[36] analyzes, the subsidiarity principle in essence, is a principle of economic efficiency. The EU value-added test to evaluate the subsidiarity, as the impact guideline indicates, is a test of 'efficiency'. EU should intervene only when the net benefits are larger than Member States' actions could convey. The test of necessity (Portuese uses the term 'the sufficiency test'), is the test of effectiveness. Portuese argues that, the subsidiarity is criticized for its vagueness, but this vagueness is actually essential for such principle to deal with weighting difference economic consequences. Both decentralization (keeping fiscal autonomy) and centralization (harmonization) can use the subsidiarity principle to justify themselves. In the context of CCCTB, the subsidiarity principle would be achieved when harmonization and maintaining diversity are balanced: EU will harmonize the tax base and the sharing formula whereas Member States will decide the actual amount of taxation by setting their own CCCTB tax rate.

To sum up, the neutrality principle that CCCTB endorses is a trio-formulation: pursuing the efficiency that takes into account the benefits principle and the subsidiarity principle. It is intriguing that such trio-formulation coincides with Richard Musgrave's formulation of three functions of taxation: macro-economy stabilization, re-distribution, and resource allocation.[37] Richard Musgrave argues that the functions of macro-economy stabilization and re-distribution should be assigned to the central-government level and the function of resource allocation should be assign to sub-national government level. The trio-formulation

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[35] Ibid., Hasen redefines taxation that can enhance taxpayers' product-ability as 'tax amenities'.

[36] See note 21, Aurelien Portuese.

[37] Scholars have elaborated based on Richard Musgrave's early work on these three functions. See McLURE Ch. E, MARTINEZ-VAZQUEZ, J. *The Assignment of Revenues and Expenditures in Intergovernmental Fiscal Relations (The World Bank Institute 2000).* [online]. Available at: https://gsdrc.org/document-library/the-assignment-of-revenues-and-expenditures-in-intergovernmental-fiscal-relations/

The original work, see MUSGRAVE, R. A. *The Theory of Public Finance*. New York: McGraw Hill, 1959, p. 1–628. Peggy Musgrave explains again that this three-branch model is the normative idea but does not necessarily match the reality, since the reality is far more complex. See MUSGRAVE, P. B. Comments on two Musgravian concepts. *Journal of Economics and Finance*, 2008, vol. 32, no. 4, p. 340–347.

neutrality coincides with Musgrave's idea of delineation of competence between central and sub-national governments. In the case of CCCTB more precisely, the scope of the group tax base and taxing powers division are decided by EU level, i.e. the Directive, but the tax rate, i.e. the exact tax burden occurs in each Member State is decided by Member States. Richard Musgrave's three functions of taxation also coincides with CCCTB's multiple purposes, including to establish a business-friendly internal market (coinciding with macro-economy stabilization function), combating BEPS problems and ensuring MNE taxpayers' economic activities to relate to where they are actually occurred (related to with redistribution function). Since CCCTB still keeps the Member States' competence to decide the corporate tax rate, it also preserves Member States' competence of 'allocating resources'.

2.3. Neutrality Is Not Identical As Intra-Nation Equity

As indicated above, I argue that, CCCTB should be evaluated against the neutrality principle that also includes the benefit principle and the subsidiarity principle, and thus the baseline of the neutrality is not a no-tax world, but a world that sufficiently public goods are provided to achieve the internal market, implemented by each Member State that can into account their diversity and maintain 'healthy' tax competition. In the context of international tax law as well as the domestic tax law, scholars have started to use the 'new benefit principle'[38] that benefits are not understood as specific benefits offered or received but should be understood as 'all relevant public goods maintaining a market' and I endorse the benefit principle in the broad sense. Different states provide different public benefits in the EU internal market, and thus it is justified for Member States to have fiscal autonomy to decide the size of the public revenue and expenditure, via a democratic process. It seems that, inter-national equity and healthy tax completion between Member States would exist

Here comes the basic question: why do we not start from the inter-nation equity, but from the neutrality and broaden it? Putting it differently, is it still logical to discuss the neutrality principle as the main normative framework when the distinction between the neutrality and equity is inevitably blurred in the context of establishing an internal market of EU? My answer is affirmative: it is still logical and necessary to start from the neutrality and extends its borderline to 'inter-nation equity' or

[38] The new benefit principle is analyzed by DODGE, J. M. Theories of Tax Justice: Ruminations on the Benefit, Partnership, and Ability-to-Pay Principles. *Tax Law Review*, 2005, vol. 58, no. 4, p. 399–461. In this paper Dodge also discussed Liam Murphy and Thomas Nagel's argument in tax and justice. It should be noted that Dodge does not agree with this new benefit principle, though he agrees with Liam Murphy and Thomas Nagel's he anti-Libertarian objective.

fairness, but not the other way around, even though I do recognize the fundamental importance of the subsidiarity and fiscal autonomy of EU Member States.

The reason is: CCCTB is a harmonization effort from EU internal market perspective; whereas inter-nation equity, developed by Peggy Musgrave and other economists, is the norm of pursing fairness between 'fully' sovereign states. EU Member States, even though they are still sovereign, have the obligation not to hinder the functioning of the internal market but to facilitate the internal market. Any EU law harmonization to pursue the internal market, should be evaluated from the efficiency perspective. Pursuing the neutrality toward the optimal status of the internal market, is still the primary norm. While designing any EU law in line with the neutrality norm, it is equally important to ensure that different EU Member States' taxing powers are divided/allocated fairly and Member States maintain their diversities and healthy tax competition. Therefore, while acknowledging that the tax neutrality principle under the EU law is in part overlapping with the inter-nation equity, these two principles are neither identical nor interchangeable.

3. Philosophical Theories As CCCTB's Justification: A Thought Experiment

3.1. The Disputes of the existence of 'Global Tax Justice' and the Corporate Tax incidence Issue

Section 3 will discuss the second main part of this paper: exploring philosophical theories regarding tax, applying these ideas to the CCCTB Proposal and examining if the CCCTB Directive us justified. Before exploring the application of well-accepted philosophical theories to CCCTB as part of EU law, we need to be aware of a discussion gap of 'global tax justice' or 'regional tax justice' in the context of European Union. Some scholars embrace the concept of 'global tax justice'[39] whereas some are skeptical.[40] Although I am of the opinion with the supporters that global tax justice does/should exist as a norm, this is not a trivial consensus but arguable as follows.

As to the first dispute, EU is not a sovereign state itself but it has supranational feature and EU law with direct effect. It is true that, until now European

[39] For example, POGGE, T., MEHTA, K. (eds.). *Global Tax Fairness*, Oxford: Oxford University Press, 2016, p.1–384.

[40] For example NAGEL, T. The Problem of Global Justice. *Philosophy & Public Affairs*, 2005, vol. 33, no. 2, p. 113–147.

Union does not levy its own direct tax from individuals or companies. Therefore, the traditional political philosophies may confront some difficulties when we try to use these theories to evaluate a supranational taxation system such as CCCTB Directive. Most political philosophies mainly describe justice as the ideal relation between individuals and a single sovereign state, not the relation between individuals and international organizations as such EU. In my view, it is still reasonable to apply these philosophies to EU corporate tax law context and I also believe that 'regional justice' or 'global justice' is an appropriate tool to evaluate EU tax laws. The theories from political philosophers do not necessarily prefer a specific tax type or tax base, but they will provide an underlying rationale that describes the ideal relationship between states and taxpayers. What we cannot deny is that, quite a lot EU law instruments have direct effect upon taxpayers. European Union has provided quite a few rights that are directly applicable to citizens, including free movements of goods, workers, service, capital and freedom of establishment. Each fundamental freedom is a right that a single EU citizen can invoke against Member States.

As to the second dispute on the actual burden of the corporate tax, corporate tax is levied upon corporations but the tax burden of corporate tax will be borne by other natural persons, such as shareholders or employees. Traditionally, it is believed that shareholders of corporations will bear the corporate tax.[41] Some scholars have started to argue that[42], employees of the companies will be the ultimate people who bear the corporate tax incidence.[43] But more recent studies also show that the corporate tax incidence is **not** necessarily significantly employees' burden.[44] Besides, when the corporate income taxation on cross-border activities in the manner of formulary apportionment, some economists like McLure argue that the factors of the formula will also lead to tax incidence effect, so customers, employees and immobile capital owners will de facto bear the corporate tax incidence.

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[41] For example Dodge reiterates this, see note 38.

[42] This seems the mainstream view currently. The academic literature review on the tax incidence, see FUEST, C. *Who bears the burden of corporate income taxation?* ETPF Policy Paper, no.1, Centre for European Economic Research (ZEW) (2015) [online]. Available at: http://www.etpf.org/papers/PP001CorpTax.pdf

[43] The economic incidence of corporate tax law is a difficult issue without consensus since early. See note 27 Kim Brooks, at p. 632. She cited an early academic discussion that demonstrates the difficulty for lawyers, see KLEIN, W. A. The Incidence of the Corporation Income Tax: A Lawyer's View of a Problem in Economics. *Wisconsin Law Review*, 1965, vol. 1965, no. 3, p. 576–605.

[44] The new empirical data showing the opposite conclusion to the mainstream theory of corporate tax incidence, see CLAUSING, K. A. In Search of Corporate Tax Incidence. *Tax Law Review,* 2012, vol. 65, no. 3, p. 433–672.

Corporate tax incidence is indeed born by natural persons, but empirically it is not clear who ultimately or significantly bear the burden. It is also possible that, shareholders, employees, investors, customers, all bear corporate tax incidence respectively, but we are not sure exactly to what extent.[45] Despite of the tax incidence issue, it is well accepted that effectively paying corporate taxation at least should not create obvious inequality to the society.[46] Aggressive tax planning scenarios by multinational taxpayers mentioned by OECD's Base Erosion& Profit Shifting reports have revealed that the corporate income tax that multinationals have paid, is far from sufficient, so multinationals are accused of creating further inequalities. In my view, the current lawful-looking but aggressive tax planning scenarios from corporate taxation, have created inequalities from two aspects: for one, creating inequality to other market competitors who do not conduct such tax planning; for the other, creating individuals who do not invest as corporate shareholders. Therefore, to negate corporate income tax completely, by arguing the actual corporate tax burden/tax incidence being by customers and employees, seems to overlook the function of the corporate tax. It might be accepted that, due to the possible tax incidence effects, corporate taxation should not be the 'only measure' to pursue re-distribution, but the tax incidence effects should not be the main reason to negate corporate taxation completely either. In Section 4 of this paper I will go back the presumption tax incidence effect of corporate tax to evaluate the weighting factor selection the CCCTB Directive.

Briefly speaking, I am of the opinion that it still makes sense to adopt the philosophical justice concept to conduct the thought experiment to examine the current CCCTB Directive Proposal, though these political philosophers' original work has not yet discussed justification of corporate taxation at the international or the regional level. The following sections will discuss different theories and examine if the CCCTB Directive Proposal in general and its several policy options are in line with these philosophical criterion of 'justice' and the reasoning. I will discuss John Rawls, Robert Nozick and Liam Murphy and Thomas Nagel's work respectively. As to the existence of the CCCTB Directive Proposal in general, they might have different reasoning

[45] For example, Clausing also indicates the complexity to model corporate tax and thus it is not definitive yet to draw conclusions on corporate tax incidence, Ibid. Moreover, there are also data showing that corporate tax incidence is on customers. See SALLEE, J. M. The Surprising Incidence of Tax Credits for the Toyota Prius. *American Economic Journal: Economic Policy*, 2011, vol. 3, no. 2, p. 189–219.

[46] The phenomenon of 'paying merely small amount of tax' has been recognized as the evidence of inequalities caused by the various planning scenarios embedded in the current (international) corporate tax systems, see PIKETTY, T. *Capital in the Twenty-First Century*. Cambridge: Harvard University Press, 2017, p. 1–93, Ch. 16.

from their perspectives but would come to the same conclusion to justify the CCCTB. But as to the specific policy options in the CCCTB, they would have different judgments.

3.2. Liberalism: John Rawls' Basic Liberty Principle and Difference Principle

John Rawls is one of the representing philosophers of liberalism. Rawls' theory of justice has established two principles of justice. The fist principle is 'the liberty principle', which means state should ensure that citizens have political liberty equally. The second principle is the 'difference principle', which means that inequality in law can only be allowed when such inequality is for the purpose of re-distribution from the better-off to the worse-off. Briefly speaking, Rawls embraces 'equality of opportunity' and heavily emphasizes 'redistribution' as justice. A state should guarantee equality of opportunity to individuals to realize their own talents and choices in a free-competition market.

What Rawls demands for a tax system of justice,[47] should ensure the individual's basic rights and liberties to be exercised freely and equally; and a tax system should also be capable of conducting some re-distribution. Here arise two fundamental questions under Rawls' theory when it comes to the EU law: (1) are EU treaty fundamental freedoms, such as free movement of workers, services, freedom of establishment 'qualified' as basic rights and liberties as Rawls mentioned? (2) If the previous answer is affirmative, do legal persons, such as companies also enjoy the EU treaty freedoms as the same as natural persons, according to Rawls' justice criterion?

These two answers are both affirmative in my view. Rawls' 'basic rights and liberties' include a set of political and economic rights. As De Boer[48] analyzed, EU treaty freedoms are in fact qualified as fundamental rights in Rawls' idea, not because these treaty freedoms are extended from property rights, but because these treaty freedoms will ensure 'equality of opportunity' and free market access of market participants in the EU. Furthermore, companies are conglomeration of real people's interest, so ensuring 'equality of opportunity' of companies will also ensure 'equality of opportunity' of real people.[49]

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[47] SUGIN, L. Theories of Distributive Justice and Limitations on Taxation: What Rawls Demands from Tax Systems. *Fordham Law Review,* 2004, vol. 72, no. 5, p. 1991–2014.

[48] De Boer argues that EU treaty freedoms are qualified as fundamental rights under Rawls' first principle. See DE BOER, N. Fundamental Rights And The EU Internal Market: Just How Fundamental Are The EU Treaty Freedoms? A Normative Enquiry Based On John Rawls' Political Philosophy. *Utrecht Law Review*, 2013, vol. 9 no. 1, p. 148–168.

[49] CJEU's jurisprudence also confirms to such interpretation. Ibid., p. 156.

Given that exercising EU treaty freedoms to pursue the internal market will promote 'equality of opportunity' according to Rawls' justice theory, the CCCTB Directive Proposal that aims to facilitate companies to exercise their treaty freedoms and conduct cross-border activities, is in line with Rawls' 'first principle of justice'. A harmonized corporate group taxation at the EU law level is justified, though CCCTB as such is not a measure to conduct re-distribution effectively. A corporate tax system in any case, should not be designed as allow the inequalities persist.

3.3. The Libertarianism: Robert Nozick's Minimal State And The Strict Benefit Principle

Rober Nozick is one representative philosopher of libertarianism. Nozick embraces the idea of a minimal state and thus he argues that taxation (and public service) should be minimum, limited to the extent of providing the necessary public service that only the government could provide. Nozick's most well-known and provocative argument is that levying taxation is equivalent to 'forced labour'[50] because individuals have to work more than they need, in order pay tax. In Nozick's view, when the government is the only institution capable of providing such public service and citizens give consent to it, the government is justified. In Nozick's view, taxation is the payment for specific public service. In other words, the benefit principle in the strict sense that views taxation as the payment to the public service, is the core concept of Nozick's theory.

A lot of types of tax would still be compatible with libertarianism's benefit principle, including the income tax.[51] The strict benefit principle will focus on the minimal state and minimal public service; when there are not sufficient link between public service and taxation levied, such taxation would be defined as injustice under the strict benefit principle.

CCCTB as such, does not seem to relate a specific public service to the MNE taxpayers. However, we can also argue that the broader sense of 'benefit' that establishes and improves the EU internal market, adopting CCCTB will provide extra benefit to economic operators in the EU to have more extended freedom of establishment and free movement of service, such benefit can justify CCCTB itself. The most direct benefits that the CCCTB will provide, is 'cross-border loss-offsetting mechanism' and the one-stop shop administrative mechanism. These 'new' benefits should justify the adoption of the CCCTB Directive.

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[50] NOZICK, R. *Anarchy, State, and Utopia*. Oxford: Blackwell, 1974, p. 1–357.

[51] BIRD-POLLAN, J. The Philosophical Foundations of Wealth Transfer Taxation. In: Bhandari M. (eds.). *Philosophical Foundations of Tax Law.* Oxford: Oxford University Press, 2017, p. 217–232.

Since Nozick endorses the minimal state, he would argue that after adopting the CCCTB Directive the tax burden should not be heavier than the companies already pay to Member States.[52] In fact, the European Commission's empirical simulation research has showed that MNE taxpayers would not bear heavier tax burden if the CCCTB is adopted, because the European Commission predict revenue reduction for several Member States,[53] and MNE taxpayers can reduce largely compliance costs.[54] Furthermore, the CCCTB harmonizes corporate tax that is already levied by Member States, not adds an extra new type of tax. The subjective application scope of the CCCTB is strictly defined in line with companies that already have been subject to corporate tax law of EU Member States.[55] The CCCTB would just replace current bilateral tax treaties between Member States. Generally speaking, adopting the CCCTB Directive based on the scope of national corporate tax law, should be consistent with the minimal state idea. Harmonization at EU level as well as setting a one-stop-shop mechanism is also consistent with the idea of a minimal state, because reducing disparities of national laws of each Member State could also streamline administrative and compliance burdens, such as filing different tax returns in different Member States. Therefore, it is justified, in Nozick's view to adopt CCCTB system, provided that such system does not create extra burden or let governments of Member States expand too much. That said, when CCCTB is designed as a harmonization measure effectively reducing tax law disparities and compliance burden, Nozick would not be negative about such system.

3.4. The Pre-tax Income as Myth Theory: Liam Murphy and Thomas Nagel

Liam Murphy and Thomas Nagel's book 'The Myth of Ownership: Taxes and Justice' has provided another view on taxation and justice. Murphy and Nagel

[52] The opposite view, see BARRY, N. The Rationale of the Minimal State (2004). [online]. Available at: https://doi.org/10.1111/j.1467-923X.2004.619_1.x Barry argued that Nozick would be against international organizations such as EU, because such creating supranational organization is 'not resurgence of individualism and economic liberty but a new form of statism'. Put it differently, Barry interpreted Nozick's minimal state would not endorse EU because according to Barry Nozick would see EU as another 'big state', not resulting in limiting EU member states. However, it is arguable.

[53] Annex XII: The impact on tax revenues of Commission Staff Working Document Impact Assessment Accompanying the document Proposals for a Council Directive on a Common Corporate Tax Base and a Common Consolidated Corporate Tax Base (CCCTB){COM(2016) 683 final} {SWD(2016) 342 final}.

[54] Ibid., Annex VII: Compliance Costs.

[55] See Article 2 of CCTB Directive Proposal and Annex 1 and Annex 2.

negates 'everyday libertarianism' derived from Nozick[56] and provocatively argues that, the natural right on pre-tax income is a myth, because taxation is essential for the state to provide public goods and earning income is based on the environment with sufficient public goods. Nozick's minimal state for Murphy and Nagel is 'too minimal'[57] and not sufficient. In other words, without taxation or such public goods, earning any pre-tax income is just impossible. Therefore, instead of regarding pre-tax income should be owned by taxpayers, Murphy and Nagel argue that, taxpayers cannot claim 100% of the pre-tax income, and the state has the legitimacy to levy tax.

Murphy and Nagel especially endorse the outcome of the free 'market', because such outcome reflects personal choices and responsibilities.[58]Murphy and Nagel argue strongly that, a well-functioning market requires comprehensive legislation and government services from all aspects, such as anti-trust legislation, the monetary policy, the transportation policy, etc.[59] Therefore taxation and government are just essential to establish a market. Since the CCCTB Directive Proposal is based on pursuing the internal market, Murphy and Nagel would recognize this justification to adopt the CCCTB Directive too.

4. Policy Options From The Different Philosophies' Perspective

4.1. The Different Attitudes to the Tax Rate Competition

As indicated above, the CCCTB system in the general sense would be justified by Rawls, Nozick, Murphy and Nagel's theories. However, when it comes to specific policy options, these philosophers might have different conclusions. One distinctive feature of the CCCTB Directive is that tax rate competition is still possible and even encouraged. After harmonizing the tax base, Member States can still set their own statutory corporate tax rate. In other words, tax rate differentials are a given fact and are not seen as non-neutral or injustice under the CCCTB Directive Proposal. In other words, tax rate competition is 'neutral' for the European Commission.

Rawls would have a different judgment on the tax rate competition and the risk of race to the bottom. Rawls' justice theory argues that, a minimum social need for every individual is necessary. If tax rate competition leads to race to the

56 *Liam Murphy and Thomas Nagel,* at p. 31 (note 2).
57 Ibid., 182.
58 Ibid., 66.
59 Ibid., p. 32–33.

bottom and thus insufficient public service provision, such system is not justice. Rawls would support a healthy tax competition under coordination. Therefore, to set up a minimum tax rate for CCCTB, in order to prevent race to the bottom and secure the minimum social need.

Nozick argues for a minimal state, and tend to see taxation as payment of specific public service. Therefore, Nozick would be in favor of tax competition in general. In case of tax rate competition to the bottom, Nozick would regard such competition as justified, when such tax competition will drive different states to reduce their tax rate, downsize the public expenditure and provide the most 'cost-efficient' public service. Nozick might also support that there is a maximum tax rate set in the CCCTB Directive to prevent Member States 'racing to the top'.[60]

According to Liam Murphy and Nagel's tax justice theory, they would be negative about tax rate competition. According to Murphy and Nagel's theory, taxpayers earn their 'pre-tax income' because they have made use various public goods provided by the government, and therefore the natural rights to 'pre-tax income' is a myth. In this regard, sufficient provision of public goods[61] is so important in Murphy and Nagel's justice concept; Murphy and Nagel will definitely be negative about the possible risk of 'race to the bottom'.

4.2. Formula Apportionment

4.2.1. The Status Quo of CCCTB's Formula: The Sales Factor, the Labour Factor, the Asset Factor

In addition to harmonizing the tax base, CCCTB has another feature: it is a formulary apportionment system. CCCTB allocates Member States' taxing powers by apportioning the MNE taxpayer's consolidated tax base according to the sales factor, the asset factor and the labour factor that are attributed to each group member. Each factor is weighted equally as one-third. The three-factor formula had been widely used in USA's state taxation practice.[62] The European

[60] Although it looks impossible, according to Pethig and Wagner's empirical data, adopting the sales factor in the formula could have the possibility for Member States to race to set a higher tax rate than the optimal one. See PETHIG, R., WAGENER, A. *Profit Tax Competition and Formula Apportionment.* CESifo Working Paper Series no. 1011 (August 2003) [online]. Available at: http://www.cesifo-group.de/DocDL/cesifo1_wp1011.pdf

[61] *Liam Murphy and Thomas Nagel,* at p. 140 (note 2).

[62] The overview of the formulary apportionment state taxation in USA, see WEINER, J. M. *Company Tax Reform in the European Union: Guidance from the United States and Canada on Implementing Formulary Apportionment in the EU*. Berlin: Springer, 2006, p. 1–122. Joann Martens Weiner's research is an important reference of the European Commission's CCCTB working group. She affirms the three-factor formula later. See WEINER, J. M. CCCTB and

Commission has taken this practice and followed several experts' advice, to adopt the three-factor formula.[63]

Nowadays, more and more tax scholars are arguing that a formula should consist of only the sales factor, because the sales factor is (claimed to be) harder to be manipulated. They argue that the labour factor and the asset factor are under taxpayers' control and thus easier to be manipulated, but even in a high jurisdiction taxpayers will still sell as much as possible and they cannot really control their customers.[64] As to the CCCTB Directive, there are some similar discussions[65] to favor the single sales factor formula. Despite of criticisms and doubts[66], the single sales factor formula has become quite popular in states of USA. Regarding the philosophers' ideas of justice we discuss, however, these philosophers might endorse that the formula consists multiple different factors, because the single sales factor formula might not fulfill their justice concepts because it only presents the very limited (though still important) aspect of the market economy: the consumption side.

In the following sections, I will further discuss the asset factor, the sales factor and the labour factor respectively from each philosopher's main concept. However, in each philosophy's perspective, they have different justifications to the current formula under the CCCTB Directive Proposal. To ensure the discussions comprehensive, I will discuss two different presumptions: the first presumption of companies' shareholders bearing the corporate tax; the second presumption that the actual tax burden is in fact on a formula's weighting factors, argued by the prominent economist McLure[67] and others.[68] Different philosophers would

Formulary Apportionment: The European Commission Finds the Right Formula. In: Weber, D. (eds.). *CCCTB: Selected Issues*. Alphen aan de Rijn: Kluwer, 2012.

63 European Commission, CCCTB' Working document No. 60 [online]. Available at: https://ec.europa.eu/taxation_customs/sites/taxation/files/docs/body/ccctbwp060_en.pdf

64 The widely cited work, see AVI-YONAH, R. S., CLAUSING, K. A. Reforming Corporate Taxation in a Global Economy: A Proposal to Adopt Formulary Apportionment, The Hamilton Project Discussion Paper (2007) [online]. Available at: https://www.brookings.edu/research/reforming-corporate-taxation-in-a-global-economy-a-proposal-to-adopt-formulary-apportionment

65 For example, LLOPIS, E. L. Formulary Apportionment in the European Union. *Intertax,* 2017, vol. 45, no. 10, p. 631–641.

66 GRUBERT, H. Destination-based income taxes: A mismatch made in heaven. *Tax Law Review*, 2015, vol. 69, no. 2, p. 43–72.

67 MCLURE, C. E. The illusive incidence of the corporate income tax: The state case. *Public Finance Quarterly,* 1981, vol. 9, no. 4, p. 395–413.

68 For example, GORDON, R., WILSON, J. D. An Examination Of Multi jurisdictional Corporate Income Taxation Under Formula Apportionment. *Econometrica*, 1986, vol. 54, no. 6, p. 1357–1373; MIESZKOWSKI, P., MORGAN, J. The National Effects of Differential State Corporate Income Taxes on Multistate Corporations. In: McLure, Ch. E. (eds.). *The State Corporation Income Tax: Issues in Worldwide Unitary Taxation*, Stanford Hoover Institution Press, 1984, p. 253–263.

have different judgments on these weighting factors under different presumptions. I will discuss the asset factor, the labour factor and the sales factor in turn under these two presumptions.

4.2.2. Rawls' Perspective About Factor Selection

Shareholders of Corporations Bearing The Tax burden: Three Factors Are All Justified

When we presume that shareholders of corporations bear the tax burden of the corporate income tax, the asset factor represents interests of jurisdiction where the assets are utilized. Rawls would be positive about the asset factor in the formula. Via corporations as a large-scale economic entities, their shareholders have the capacities to make use of more resources and thus own more assets than individuals.

When we assume shareholders of corporations bearing the ultimate burden, the labour factor represent the human resources that corporations make use of. Rawls would be positive about the labour factor in the sharing formula, because the jurisdiction where employees are located, would maintain a labour market that employees compete with each other and corporations can choose the most suitable employees. Rawls would also be positive about the sales factor in the formula. It should be noted that Rawls might not be very interested in the single sales factor formula, because although the single sales factor formula will only focus on the demand side of the market. Furthermore, the difference principle that endorses redistribution function will not be achieved.

Presumption of The Tax Incidence Effect On Factors: Only The Asset Factor And The Sales Factor Are Justified

However, when we preseume that the tax incidence effect of the payroll factor, there would be different reasoning. Rawls would be negative about the labour factor, because in the end of the say, it is immobile employees bearing the burden, so the labour factor cannot fulfill the purpose of re-distribution.

Rawls would be still positive about include the asset factor in the formula. The effect of including the asset factor in the formula is to putting tax incidence on capital owners. Since Rawls emphasizes the function of re-distribution, tax incidence on capital owners would actually fulfill the res-distribution function of the taxation.

Furthermore, according to Mclure's claim, adopting the sales factor of the sharing formula has the tax incidence effect on consumers. In Rawls' opinion of pursing re-distribution, he would support the sales factor in the formula. Rawls has clearly expressed that his support to consumption tax. Due to Rawls' support to the consumption tax, Rawls would be very interested in a single sales factor formula, because a single sales factor formula would be equivalent to a type of sales tax, if we presume Mclure claim as true.

4.2.3. Nozick's Perspective about Factor Selection

Shareholders of Corporations Bearing The Tax burden: Three Factors Are All Justified

Generally speaking, Nozick would be negative about any tax burden levied on assets, because he believes in the natural right on the asset. However, in case of corporate income tax that is presumed to be born by companies, he would be positive about the asset factor in the formula, because sovereign states, via a corporation law system as such, provide more benefits to companies than individuals: a company has its own legal personality so its shareholders can separate the asset of corporations from their personal assets. Companies have limited liability and enhanced creditability in the market economy. This is a benefit that an individual business persons could not enjoy. Besides, Nozick would be also positive about the labour factor. Nozick would accept that the government provides public service, such as education, so the quality of labour is guaranteed. Shareholders can hire qualified employees via their corporations to conduct all the economic activities. Nozick would be also positive about the sales factor, based on his view of minimal state and the strict benefits principle. The state provides a competitive market for corporations to provide their goods and service to their customers. 'Regulating the market' has been recognized as a type of public service, even in a libertarian's view.[69]

Presumption Of The Tax Incidence Effect On Factors: Only The Sales Factor Is Justified

Nozick's judgment would be quite different, if we accept the tax incidence effect of the asset factor according to Mclure's claim. Nozick would be immediately negative about have the asset factor in the formula, because he is in general quite negative about levying tax upon assets. Therefore, if including the asset factor in the formula has the same tax incidence effect on the capital owner, Nozick would not endorse the asset factor because the capital owners of the corporations would be the one carrying tax burden. Nozick would see the asset factor as restriction to capital owners to make use of their own money. Nozick would be also negative

[69] See note 51 Jennifer BIRD-POLLAN.

about the labour factor under the tax incidence effect either, because Nozick has been always critical about wages tax and sees such tax as being limitation to personal freedoms.

Under the tax incidence effect presumption, Nozick would be also positive about the sales factor even if the actual tax burden is actually consumers. The regulation of the market has been recognized as a type of public service, and such regulation would apply to both customers as well as companies, and thus even if the sales factor would have the tax incidence on customers, the sales factor is justified because it relates to the public service of 'regulating a market'.

This reasoning of 'regulating the market' as a type of public service might sound a bit counter Nozick. We might have presumed that Nozick could have argued that with the tax burden, consumers cannot freely make their own choices to purchase and customers would never be able to give their consent to such tax burden, because it is an invisible one resulting from the tax incidence effect. However, it is important to note that, Nozick's core concept is a 'minimal state', not a pure anarchy nor a 'no state'. Therefore, if the result of 'regulating the market' has streamlined the government and grants more freedom for individuals, Nozick would still support such regulation.

4.2.4. Liam Murphy And Thomas Nagel's Perspective

Shareholders Of Corporations Bearing The Tax Burden: Three Factors Are All Justified

When we assume shareholders bear the corporate tax burden, Murphy and Nagel would also be positive about the asset factor in the sharing formula. In their view, the so-called pre-tax income is actually the result guaranteed by the government, and therefore it is justified for a state where corporations make use of their assets to conduct business, to levy corporate tax based on their assets.

With the similar rationale, Murphy& Nagel would be positive about the labour factor. In Murphy& Nagel's view, it would be justified to levy corporate tax based on corporate taxpayers' employees, because the state provides the education system to ensure employees' quality, for example.

Murphy& Nagel would be affirmative to include the sales factor in the formula, because the sales represent directly the result of the market.[70] Corporations make use of the consumer's market to make profits and thus it is justified to choose the sales factor in the formula.

[70] See note 66 Liam MURPHY and Thomas NAGEL.

Tax Incidence Of Factors Is Not The Main Concern Of Murphy & Nagel: Three Factors Are Justified

It should be noted that, Murphy and Nagel have been aware of the possibility of shifting corporate tax incidence to labour, but they argue that tax incidence is not the main concern of justice, but the 'social outcome'.[71] This is a main difference from Rawls and Nozick's thoughts. Therefore, for Murphy and Nagel, justification of levying a type of tax does not rely on the real tax incidence. In Murphy& Nagel's view, they would be also positive about the asset factor and the sales factor in the formula as well. Murphy& Nagel would still be positive about the labour factor in the formula even if the tax incidence effect on the immobile employees. As long as the government can achieve a fair social outcome, no matter the tax incidence effect falls on immobile employees, capital owners, or customers, it will not influence the justification of levying corporate tax.

4.2.5. Summary Of Three School Of Thoughts

It is clear that, a three-factor formula would be justified based on three schools of philosophies above, i.e. Rawls, Nozick, Murphy and Nagel, when we presume that shareholders are the real entities bearing the tax burden as the most traditional view. Even the classical libertarian Robert Nozick would be affirmative to a three-factor formula.

However, when we also take into account the tax incidence effect argument of the formula factors, the tax burden of corporate income tax, these philosophers' attitudes towards the labour factor and the asset factor would not be always the same. From Rawls' perspective, if corporations bear tax burden themselves, Rawls would be positive about the labour factor because corporation tax based on employees is consistent with his re-distribution concept: taxing the better-off who can have extra capital to invest and hire other people. When the corporate tax incidence is in fact on employees due to adopting the labour factor in the formula, Rawls would be skeptical to the labour factor, because the tax incidence effect on employees' payroll is contrary to the re-distribution objective of taxation. From Nozick's view, when taking into account the tax incidence effect, Nozick would be negative about the asset factor, because the tax incidence effect would be falling on owners of immobile assets. This would be contrary to Nozick's conclusion if we presume shareholders bearing the tax burden and enjoy the benefits of limited liability and separating the assets of corporations and the assets of shareholders. Nozick would also be negative about the labour factor

[71] Ibid., 131.

if the tax incidence falls on employees. Being quite different from Nozick and Rawls, Murphy and Nagel express that the tax incidence effect will not influence their judgment on tax justice, so from their philosophical view, the three factor formula will be still accepted.

It seems to me that, the neutrality derived from the CCCTB Directive, is the middle way of these three schools of philosophical thoughts. As to the tax rate competition, CCCTB Directive allows the tax rate competition between EU Member States, and Nozick would immediately accept this position, because it is consistent with Nozick's minimal state rationale. Rawls and Murphy& Nagel would be more concerned about the problem of 'race to the bottom' issue than Nozick. As to the formulary apportionment, the neutrality of CCCTB seems consistent with Liam Murphy and Thomas Nagels' idea of tax justice,[72] especially when the benefits principle is interpreted broadly as 'providing the pre-condition' of the market economy, not to require the causal link of a specific benefit received or provided. Therefore, the CCCTB Directive Proposal adopts three weighting factors that reflect different economic activities from the production side to the customers side. The CCCTB Directive Proposal does not seem to take into account Mclure's well-known claim of the tax incidence effect of the formulary apportionment, because it refers these weighting factors as the indicators of 'where the companies' profits are actually earned'.

5. Conclusion: Toward A Broad-Sensed Tax Neutrality As Tax Justice

The neutrality principle that regulates the EU tax law harmonization is trio-formulation: efficiency, the benefits principle and the subsidiarity principle. The baseline of evaluating the neutrality should not be the hypothetical non-tax world, but a well-functioning market that tax contributes to build up. The trio-formulation of neutrality is also suitable to regulate the competence division between Member States and EU, and it accepts the very existence of shared competence, such as pursuing an internal market. In the context of EU tax law that aims 'to establish a market', the neutrality norm and inter-nation equity will converge; CIN and CEN will also be achieved at the same time.

Intra-nation equity and tri-formulation neutrality cannot be separated, so the norm of neutrality is understood as broadly. In this regard, the broad-sensed

72 It should be noted that Murphy and Nagel have expressed that their doubts regarding the classical meaning of benefit principle, though. Ibid., p. 31, under the subtitle of 'The Problem of Everyday Libertarianism'.

neutrality principle is partially overlapping with the scope of the 'justice' concept that has been long argued and discussed by political philosophers. Since the very existence of government relies on tax collection, whether a tax system is 'neutral', is also the core question of 'whether the government levies a tax as such is justified'. Most philosophers are not tax law scholars, and focus more on 'social justice' instead of tax justice, and thus they rarely discuss in detail on justification of a specific type of tax or specific policy options. Even they touch upon the tax, philosophers usually only discuss taxes levied upon individuals, not corporations. Therefore, the discussions above contribute to bridge the gap between these theories and the idea of tax neutrality.

While applying Rawls' liberalism, Nozick's libertarianism, and Murphy and Nagel's ownership myth and tax justice theory to analyze different aspects of CCCTB as if doing the thought experiments, I draw the conclusions as follows: based on these three schools of thoughts, CCCTB as a corporate taxation system at the EU law level, is justified. The tax rate competition under the CCCTB that possibly leads to 'race to the bottom' would not be accepted by Rawls and Murphy& Nagel's theory. Nozick would be more comfortable with the tax rate competition. As to justifications to the formulary apportionment method, when we presume the corporations as the real entity bearing the tax burden, that is the shareholders who make use of the form of the corporation to conduct business, three school of thoughts would all be positive about the three-factor formula which consists of the sales factor, the asset factor and the labour factor.

I have to admit that there are unsolved puzzles when it comes to the tax incidence effect of formulary apportionment argued by many economists. This presumed effect seems to make the philosophical reasoning murky. Nozick would be negative about the labour factor and the asset factor, because these two factors will make the corporate taxation as *de facto* payroll tax and asset tax, and owners of immobile properties and immobile employees will bear the actual burden. Such tax incidence effect is contrary to Nozick's basic belief that individuals' liberty should prevail other policy objectives. Rawls would also be negative about the labour factor, because the tax incidence effect will shit burden to immobile employees, and this seems directly contrary to Rawls' re-distributive justice. What still intrigues me is that, tax incidence effect of formulary apportionment and corporate tax, has been widely discussed but there is never a clear consensus even between economists. So I tend to be cautious about the policy implications derived from the claims on 'who de facto bears the corporate tax burden', especially in the formulary apportionment context, although this is still a puzzle for me. Therefore, being similar to Murphy and Nagel, I am of the opinion that the justification of a specific tax policy option is not based on the tax incidence effect, but the overall outcome after levying such tax.

Finally, while embracing the neutrality that takes into account 'inter-nation equity, when it comes to BEPS, aggressive planning, and tax avoidance concerns, I am cautious about the arguments of directly naming, shaming, and blaming MNE taxpayers. In other words, I do not see these problems as MNE taxpayers' 'fault', but a systematic failure of the current international corporate tax system, which is deviating from the tax neutrality. MNE are active economic actors in the market and can create employments and stimulate better production and consumption. I am also cautious about the current harmful tax competition claim that argues for a harmonized tax rate, because even in an integrated market, not every part of the market (i.e. every Member State) is homogeneous. Keeping diversity of EU Member States and freedom to compete is the opportunity to develop the most suitable public service from Member States. The neutrality principle in the broad sense, taking into account the benefit principle and the subsidiarity principle, would be a more appropriate norm of tax justice, to guide a supranational system such as CCCTB that involves interactions between MNE taxpayers, EU and Member States.

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