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Luzius U. Cavelti,* Christian Jaag** and Tobias F. Rohner***

Why Corporate Taxation Should Mean Source Taxation: A Response to the OECD's Actions against Base Erosion and Profit Shifting

It is widespread practice around the world that corporate entities pay taxes to the country where they are formally registered and to the country in whose territory they generate income. While the former is generally known as the "country of residence" the latter is usually referred to as the "country of source". This article questions separate taxation based on this distinction between the country of residence and the country of source. It argues for a departure from the traditional international allocation of the right to tax corporate income and suggests that a corporate entity should instead pay income tax exclusively to the countries in which it has relevant business activities. In other words, this article advocates a "source-based corporate income tax", meaning the global allocation of corporate income based on the source of income. Moreover, in examining the question of where business activities of multinational corporations effectively take place, this article describes criteria for determining source countries. Furthermore, it offers a method for formulary apportionment of corporate income between those countries in which a given multinational corporation generates income. The article argues that source taxation of corporate income would be coherent with the economic nature of corporate income taxation. Source taxation of corporate income would also make the arbitrary concept of corporate residence irrelevant, and it would allow the outdated legal concept of permanent establishment to be abolished. This article takes an interdisciplinary approach to argue from both legal and economic perspectives. It adds to the body of literature that discusses how countries should tax corporate entities doing business across national borders. It also contributes to the ongoing debate about the OECD's recent controversial efforts to prevent corporations shifting profits between countries to minimize their exposure to national tax systems (base erosion and profit sharing, or BEPS).

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