POLITICAL CHALLENGES TO IMPLEMENTING AND SUSTAINING FUNDAMENTAL REFORM: A COMPARATIVE CASE STUDY ANALYSIS OF ACE IN PRACTICE

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Fundamental tax reform evokes strong political reactions from policy makers and industry groups, and the Allowance for Corporate Equity (ACE) is no exception. Following much debate, the distinct benefits of ACE have resulted in ACE-variants being implemented in several jurisdictions. This paper investigates the political hurdles to implementing the Belgian “Notionele Interestaftrek” and the Italian “Dual Income Tax” and “Aiuto alla Crescita Economica”, and evaluates the rationale for any subsequent legislative changes. Further, this paper considers economic, political and administrative issues in sustaining this fundamental reform and investigates whether subsequent legislative changes have more closely aligned the Belgian and Italian ACE-variants to the original objectives of ACE.

The original objectives and perceived benefits of ACE include encouraging domestic investment and employment, and achieving tax neutrality by granting tax relief for equity financing. In principle, many leading commentators, policy makers and corporations support ACE. However, in practice, fundamental reform of the corporate income tax system is notoriously difficult. In the Australian context, the Business Tax Working Group recently recommended that ACE remain on the reform agenda, albeit as a longer term option. Accordingly, this paper aims to provide a useful reference point for Australian policy makers’ future considerations of ACE reform and, more specifically, to glean insights from the Belgian and Italian experiences for policy makers seeking to implement ACE-variants.
1 THE DEBT-EQUITY DISTORTION: ISSUES IN THE AUSTRALIAN CONTEXT

While great minds may differ, depending on their ideological and political backgrounds, on the correct balance between the equity and efficiency trade-off leading economists and policymakers agree that departures from economic efficiency (i.e. neutrality) can create opportunities for tax avoidance¹ and are therefore undesirable, albeit at times inevitable for practical reasons. Therefore, from a tax policy design perspective, it is imperative that the tax system minimises the distortionary effect of taxes.²

The debt-equity distortion is a primary example. In the Australian context, the Henry Review observed that “Tax-induced distortions to financing decisions should be reduced to avoid encouraging firms to rely excessively on debt finance and to avoid biasing other financial decisions, such as dividend payouts. However, it is difficult to reduce distortions to financing decisions without a business level expenditure tax such as an ACE.”³ More recently, the Business Tax Working Group (“BTWG”) recommended that the Allowance for Corporate Equity (“ACE”) remain on the reform agenda, albeit as a longer term option. Instead, the BTWG recommended lowering the corporate income tax rate to encourage investment in Australia,⁴ suggesting that “A reduction in the company tax rate would also reduce distortions in the tax system relating to financing decisions”.⁵ While it is arguable that simply lowering the headline rate of corporate income tax (“CIT”) does not constitute tax reform per se, the tension between implementing an ACE and lowering the CIT rate is very

commonly experienced by policymakers. Further, in jurisdictions such as Australia, where full imputation systems are in place, significant distortions between debt and equity financing arguably only arise in the cross-border context.

1.1 ISSUES IN THE CROSS-BORDER CONTEXT

The inconsistent treatment of debt and equity financing across various domestic and international tax rules creates tax arbitrage opportunities, particularly for MNCs. The literature acknowledges the role of the distortionary tax treatment between debt and equity financing, and the complex classifications of debt and equity, in encouraging debt shifting to relatively higher-tax jurisdictions. Specifically, interest expenses paid on foreign debt financing are deductible against the corporate income tax base, subject to its classification as debt rather than equity, the thin capitalisation rules and withholding taxes. This can result in double non-taxation, as well as no or low tax liabilities in higher-tax jurisdictions.

Accordingly, it is important to assess the effectiveness of the relevant tax laws; namely, the debt-equity rules, the thin capitalisation rules and withholding taxes in this context, to be dealt with in turn as follows:

1.1.1 Debt-equity rules

It is well documented in the literature that the debt bias encourages firms’ use of debt financing to minimise their tax liability, with debt bias distortions increasingly gaining attention from academic

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7 Currently, Australian rules do give differential and distortionary treatment of debt and equity in the cross border context. Even then the distortions are not uniform and will differ according to factors such as: (a) Foreign thin capitalisation rules or exemptions in the home country; (b) Bilateral Treaties with the home country (or lack thereof); (c) Portfolio or non-portfolio investors; see further, Henry K, Harmer J, Piggott J, Ridout H and Smith G, Australia’s Future Tax System: Report to the Treasurer, Commonwealth of Australia, December 2009, Part 2, Chapter B1–4, available at: http://ftrreview.treasury.gov.au/content/FinalReport.aspx?doc=html/publications/Papers/Final_Report_Part_2/chapter_b1-4.htm.
9 de Mooij RA, ‘Tax Biases to Debt Finance: Assessing the Problem, Finding Solutions’ (2011) IMF Staff Discussion Note No 11/11, 3 May 2011 (Washington: International Monetary Fund); see further, International
studies, indicating its increasing importance. Governments and policymakers are increasingly aware that the favourable treatment of debt over equity finance encourages excessive reliance on debt financing, is vulnerable to tax competition\textsuperscript{10} and makes corporation tax avoidance easier.\textsuperscript{11}

Domestic and international debt-equity rules’ classification complexities are prone to tax arbitrage, exemplified by financial transactions involving hybrid financing.\textsuperscript{12} In \textit{Commissioner of Taxation v Noza Holdings Pty Ltd},\textsuperscript{13} which is the only s820-40 ITAA97 case concerning a MNC, the use of fully-paid redeemable preference shares led to the full Federal Court allowing tax deductions of $170,983,354. This case was the impetus for Australia’s then Assistant Treasurer’s statement that “\textit{if this is the kind of behaviour the international tax system encourages then it needs to be changed}”.\textsuperscript{14} This call for fundamental reform in the international tax system is echoed by the OECD through its Action Plan on Base Erosion and Profit Shifting (BEPS), which states “\textit{This Action Plan calls for fundamental changes to the current mechanisms and the adoption of new consensus-based approaches, including anti-abuse provisions, designed to prevent and counter base erosion and profit shifting}”\textsuperscript{15}

\subsection*{1.1.2 Thin capitalisation rules}
Opportunities for international tax avoidance through the shifting of debt between jurisdictions is increasing as the world’s economy becomes more integrated, resulting in many OECD members’ introducing specific rules to deal with thin capitalisation arrangements over the last decade.\textsuperscript{16} This has been supplemented by the OECD BEPS Report, which identifies thin capitalisation rules as a key

\begin{thebibliography}{99}
\bibitem{Commissioner2012} \textit{Commissioner of Taxation v Noza Holdings Pty Ltd} [2012] FCAFC 43.
\bibitem{Bradbury2013} Bradbury D, ‘Stateless Income – A threat to national sovereignty’ (Address to the Tax institute of Australia’s 28\textsuperscript{th} National Convention, Perth, 15 March 2013).
\end{thebibliography}
pressure area underlying the taxation of cross-border activities.\textsuperscript{17}

It is well established by the economic literature that “\textit{Departures from neutrality, whether in the form of concessions or lack of alignment between different taxes, are some of the principal building blocks which so-called ‘tax planners’ use to erect schemes of (legal) tax avoidance, often of a highly artificial kind}”. This fundamental good tax policy design consideration is not directly addressed by recent reform proposals to the Australian regime.\textsuperscript{18} However, it is arguably counter-intuitive for an anti-avoidance regime governing financing to overlook financing neutrality considerations. Accordingly, in subsequent research this author will consider the more preliminary question of whether thin capitalisation rules, despite limiting debt deductions, are effective in achieving financing neutrality – in both theory and practice.

OECD member countries (including Australia, Germany, New Zealand, Canada, Sweden, Portugal and Belgium) are increasingly tightening their thin capitalisation rules to limit excessive debt deductions and thereby protect their corporate tax bases. Empirical evidence suggests that limiting interest deductibility in the cross-border context, for example through thin capitalisation rules, successfully restricts internal borrowing by MNCs.\textsuperscript{19} However, this is worth investigating because this literature is limited to analysing the impact on intercompany loans, omits hybrid financing and the

\begin{footnotesize}
\begin{itemize}
\item[\textsuperscript{17}] “The report analyses the root causes of BEPS and identifies six key pressure areas: (1) hybrids and mismatches which generate arbitrage opportunities; (2) the residence-source tax balance, in the context in particular of the digital economy; (3) intragroup financing, with companies in high-tax countries being loaded with debt; (4) transfer pricing issues, such as the treatment of group synergies, location savings; (5) the effectiveness of anti-avoidance rules, which are often watered down because of heavy lobbying and competitive pressure; (6) the existence of preferential regimes”, Saint-Amans P and Russo R, \textit{What the BEPS are we talking about?} (8 April 2013) OECD Centre for Tax Policy and Administration, available at: http://www.oecd.org/ctp/what-the-beps-are-we-talking-about.htm; see further, OECD, \textit{Addressing Base Erosion and Profit Shifting} (2013) OECD Publishing, Paris, available at: http://dx.doi.org/10.1787/9789264192744-en.
\end{itemize}
\end{footnotesize}
financial sector,\(^{20}\) does not consistently consider inbound FDI; and, typically utilised datasets from the United States\(^{21}\) or European countries such as Germany.\(^{22}\)

The complexity of international taxation makes it difficult to precisely measure tax arbitrage incentives in a particular country of study, let alone extrapolate for other jurisdictions. For example, the analysis of the German case is much more straightforward than an analogous study of the US case, where taxes on foreign earnings are subject to a foreign tax credit and interest allocation rules apply.\(^{23}\) Accordingly, the range of empirical literature has limited applicability both in the Australian context and generally because of the difficulties in reflecting the complexity of the international tax system in empirical studies and models.

Further, leading commentators observe that restrictions on interest deductions do not eliminate the debt bias and are likely to be imperfect\(^{24}\) because they bring considerable new complexities\(^{25}\) and opportunities for tax avoidance.\(^{26}\) Accordingly, it is unclear whether tightening thin capitalisation rules is the most effective approach to the problem of corporate tax base erosion from cross-border tax arbitrage by MNCs.

Importantly, the thin capitalisation rules were not originally designed to eliminate the fundamental tax

\(^{22}\) For example, a large micro-level panel dataset of virtually all German MNCs compiled by Deutsche Bundesbank, which included information about the actual amount of internal debt used by foreign affiliates, distinguished into loans from the parent and loans received from other foreign affiliates; see further: Buettner T and Wamser G, ‘Internal Debt and Multinational Profit Shifting: Empirical Evidence form Firm-level Panel Data’ (2013) 66(1) National Tax Journal 63, 69.
distortion in the tax treatment between debt and equity financing. Rather, their primary motivation was to act as anti-avoidance measures through the defence of source-based taxation.\(^\text{27}\)

Over three decades ago, in the context of thin capitalisation rules, the OECD recognised the design challenges to counter tax arbitrage from the debt-equity distortion, but offered no solution. Rather, the following observation was made:

> “Since for tax and other reasons equity contributions may be disguised as loans, a distinction has to be made between the two ... As things stand today, there is a distinct possibility that the same financial transaction could be treated as loan by one country and as an equity contribution by another, either because the country of the lender takes a different view from the country of the borrower or because borrowers of the same MNE in different countries who are involved in what, to the MNE, seem to be similar transactions are treated differently by different national tax authorities. This is an unsatisfactory situation which it would be desirable to improve ... A hard and fast debt-equity rule would, however, not be appropriate for the solution of problems raised by the determination of the nature of a financial transaction. Financing practices differ too widely from one country to another, and, within a given country, between different categories of enterprises”\(^\text{28}\)

This challenge has been acknowledged by, but remains unaddressed in, the most recent OECD publications.\(^\text{29}\) Similarly, Australian policymakers continue to observe that the thin capitalisation rules and debt-equity rules reflect the tax bias in favour of debt financing, resulting in administrative difficulties and tax arbitrage opportunities.\(^\text{30}\)


\(^{28}\) OECD, Transfer Pricing and Multinational Enterprises (OECD Publishing, 1979), 86–89.


The literature also highlights a lack of consensus on the best approach to designing thin capitalisation rules. For example, there is currently little consensus among legal commentators, with many rejecting and others supporting the OECD interpretations over the past two decades. The crux of the criticisms is that the OECD approach to thin capitalisation rules has little conceptual foundation and omits tax policy design considerations, with leading commentators observing that “The thin capitalization problem has been discovered relatively recently and is considered an important issue by some (but by no means all) countries. Article 9(1) OECD-MC has simply not been written with this issue in mind”. This raises the issue of whether domestic tax policy considerations should be applied in a cross-border or international context, and also questions the relevance of the current OECD approach, given the OECD Model Tax Convention on Income and Capital (“OECD Model Tax Convention”) was developed with a focus on inter-governmental relations rather than how individual governments should deal with MNCs.

Further, while the OECD Model Tax Convention was originally prepared with the overarching objective of eliminating double taxation, the challenge presented today is that of double non-taxation. The arm’s length approach, which remains the international standard in transfer pricing, can be traced from the OECD Model Tax Convention back to the Carroll Reports. However, the OECD Transfer Pricing Guidelines regarding the arm’s length approach in a thin capitalisation context are not definitive. Indeed, thin capitalisation rules and tax arbitrage considerations relevant to the thin

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capitalisation rules were not contemplated by the original drafters of the OECD Model Tax Convention. Thin capitalisation issues were only briefly considered in the 1979 Report on Transfer Pricing and Multinational Enterprises (“1979 Report”), at paragraphs 183 to 191.\(^3\) Interestingly, the 1979 Report anticipated tax arbitrage opportunities arising from the operation of different rules by different countries such that the same financial transaction could be treated as debt by one country and as an equity contribution by another but “did not provide any but the most tentative guidelines”.\(^3\)

Further, thin capitalisation rules have only in the past decade been regarded as one of the classic fields of international tax law, after two decades of discussion at the international level.\(^4\)

Therefore, since the OECD materials on thin capitalisation rules have little conceptual foundation, they should arguably not be relied upon for the basis for addressing design challenges to domestic thin capitalisation rules in the Australian context. This proposition is supported by the Board of Taxation statement that “the OECD uses the term thin capitalisation in a different sense to that in Division 820 of Australia’s tax law”.\(^4\)

It is noteworthy that the Commentary on Article 9(1), the basis for allowing contracting states’ domestic thin capitalisation rules, is one of shortest Commentaries on the articles

\(^4\) The OECD approach is to determine the free capital that an independent enterprise carrying out the operations of the permanent establishment in the same jurisdiction would have, subject to the same creditworthiness principle: Board of Taxation, ‘Review of Tax Arrangements Applying to Permanent Establishments’ (October 2012), 20.
of the OECD Model.\(^{42}\) Indeed, there is no provision dedicated to the thin capitalisation issue nor the various types of thin capitalisation rules; rather, it is considered a branch of the transfer pricing issue,\(^{43}\) as indicated in the OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations. For example, Article 9(1), paragraph 56 typically only dealt with thin capitalisation rules which recharacterised interest as a dividend, and was only recently clarified as applying more generally to thin capitalisation rules that disallow the deduction of interest.\(^{44}\) This statutory codification arguably adds further complexity to an area of international tax law that leading practitioners have criticised as circular and complex.\(^{45}\) Further, thin capitalisation rules have not been specifically considered in the historical development of tax treaties and are commonly not directly dealt with by them,\(^{46}\) and where applicable are carved out of every non-discrimination article entered into through an Australian tax treaty.\(^{47}\)

Future research by the author will critically analyse the history of the development of the OECD Model Tax Convention as it relates to thin capitalisation rules. It is hoped that this analysis may provide a clear statement of principles which can be systematically applied to the Australian context when drafting domestic thin capitalisation rules and tax treaties, which would be beneficial from both an administration and a compliance perspective.

Specifically, the starting point is anticipated to be the four interim Reports leading up to the 1963 draft OECD Model Tax Convention,\(^ {48}\) the first one of which was published on 1 July 1958.\(^ {49}\) These


\(^{43}\) Harris P and Oliver D, International Commercial Tax: A UK Perspective (Cambridge University Press, 2010), 256.


\(^{46}\) Harris P and Oliver D, International Commercial Tax: A UK Perspective (Cambridge University Press, 2010), 344.


\(^{49}\) Professor Michael Lang has published the reports of the various OECD Working Parties that led up to the OECD Model; see further, for an account of the role of OECD archival materials in interpreting tax law, Lang M,
Reports and all subsequent Conventions, Commentary and Guidelines will also be analysed to investigate and glean insights into the policy considerations, theory and pragmatism of the time.

1.1.3 Withholding Taxes
At face value, it appears that the debt-equity distortion is also manifest in the higher withholding tax rate for unfranked dividends (at 30%) in comparison to interest (at 10%). However, under current Australian treaty practice, dividend withholding tax on unfranked dividends varies between 0–15% and interest withholding tax has been significantly phased down. Importantly, the Henry Review criticised Australia’s current treatment of foreign debt as complex and distortionary, recommending a reduction in the interest withholding tax rate to zero among tax treaty partners:50

“While interest withholding tax is applied notionally at a rate of 10 per cent, in aggregate the effective tax rate is around 3.5 per cent given the wide range of available exemptions ...
Although interest withholding tax is imposed on the non-resident lender, it is likely to be passed onto Australian borrowers by way of higher interest rates on their borrowings — increasing their cost of capital and reducing domestic investment ... In particular, the current arrangements are likely to influence how Australian businesses and households access foreign debt capital, potentially distorting competition between financial service providers and reducing the stability of the financial system, and leading to a misallocation of that capital away from its most productive uses in favour of less productive investments that have better access to debt.”

With an effective interest withholding tax rate of 3.5%, liability for withholding tax would likely not outweigh the advantages of interest deductibility given comparative levels of corporate tax. While the literature has recognised the debt-equity distortion as prevalent in the foreign debt context, leading policy makers have called for the reduction of interest withholding tax to 0% provided appropriate

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safeguards exist to limit tax avoidance. An analysis of the historical evolution of Australia’s interest and dividend withholding tax regimes will be conducted by the author in future research, with an emphasis on the efficiency-compliance trade-off and the relative administrative merits of these policies.

2 FUNDAMENTAL TAX REFORM TO ADDRESS THE DEBT-EQUITY DISTORTION: ACE

There are many reform proposals addressing the debt-equity distortion; namely, ACE, Cash flow tax, Comprehensive Business Income Tax ("CBIT"), DIT and Residence-based shareholder tax, as outlined in the below table:52

<table>
<thead>
<tr>
<th>Distortion to</th>
<th>Reform proposal addressing distortion</th>
</tr>
</thead>
<tbody>
<tr>
<td>Choice between debt and equity</td>
<td>ACE, Cash flow tax, CBIT, DIT, Residence-based shareholder tax</td>
</tr>
<tr>
<td>Choice between new equity and retained earnings</td>
<td>ACE, Cash flow tax, CBIT, DIT, Residence-based shareholder tax</td>
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<tr>
<td>Choice of organizational form</td>
<td>ACE, Cash flow tax, CBIT, DITa, Residence-based shareholder tax</td>
</tr>
<tr>
<td>Domestic real investment</td>
<td>ACE, Cash flow tax</td>
</tr>
<tr>
<td>International location of real investment</td>
<td>Residence-based shareholder tax, Residence-based corporate income taxa, VAT-type destination-based cash flow tax</td>
</tr>
<tr>
<td>International location of tax base</td>
<td>Residence-based shareholder tax, Residence-based corporate income taxa, VAT-type destination-based cash flow tax</td>
</tr>
</tbody>
</table>

The ACE is the focus of this paper. The ACE maintains the current deductibility of actual interest payments and adds a notional return on equity to be deductible against corporate profits; at the risk-free nominal interest rate.54 ACE has garnered substantial support from leading academics since its theoretical inception and is experiencing increased interest from policy-makers internationally.55

In terms of its historical development, ACE originated in the 1970’s with the basic economic idea

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54 De Mooij RA and Devereux MP, ‘An applied analysis of ACE and CBIT reforms in the EU’ (2011) 18(1) International Tax and Public Finance 93, 96.
contained in the report of the Meade Committee,\textsuperscript{56} which proposed alternatives to the UK tax system. This was followed by research published by leading commentators Boadway and Bruce,\textsuperscript{57} and was further elaborated in detail by the IFS Capital Taxes Group,\textsuperscript{58} and Devereux and Freeman.\textsuperscript{59}

The literature has predominantly focused on economic concepts, despite recognizing the relevance and importance of law, accountancy and politics.\textsuperscript{60} Further, the ACE literature currently has a corporate tax neutrality focus grounded in the economics paradigm. Importantly, ACE-based reforms have great potential from an anti-avoidance law perspective, which is especially pertinent for international company tax purposes.\textsuperscript{61}

Accordingly, it is necessary to consider how these perceived benefits of ACE eventuate in practice.


3 CASE STUDIES: BELGIAN AND ITALIAN ACE-VARIANTS

The original objectives and perceived benefits of ACE include encouraging domestic investment and employment, and achieving tax neutrality by granting tax relief for equity financing. In principle, many leading commentators, policy makers and corporations support ACE. However, in practice, implementing and sustaining fundamental reform of the corporate income tax system is difficult. This paper analyses the Belgian and Italian ACE-variant experiences, with a focus on the political hurdles to implementing and sustaining these reforms.

3.1 BELGIUM

The Belgian corporate tax system is considered a classical double taxation system, modified by an exemption for dividends from qualifying participations held by corporate shareholders and a reduced rate for dividends from participations held by individual shareholders. Tax practitioners have long considered Belgium an interesting jurisdiction for various tax-planning and structuring purposes.

Even prior to the introduction of the Notional Interest Deduction (“NID”), dividends could be received nearly tax-free, interest paid on loans taken out to acquire shares was tax-deductible and capital gains on shares were generally tax-exempt. The NID (otherwise known as the “Intérêts notionnels et déduction fiscales pour capital à risque”, “Notionele Interestaftrek” or “Capital Risk Deduction”) was introduced in 2005 to encourage equity financing following two key pressures; first, pressure from the European Commission to abandon the Belgian coordination center regime.

Second, following the expansion of the EU to countries with lower corporate tax rates, such as Cyprus, Latvia, Lithuania, and Hungary, which emphasized the need for Belgium to strengthen its position on the international tax map.

3.1.1 NID: POLITICAL HURDLES TO IMPLEMENTATION
When initially introduced in Belgium, leading commentators observed that Belgium’s NID reform was very close to the pure version of the ACE, with the Parliamentary focus appearing to be the tax neutrality property of the NID to overcome the debt-equity distortion. The originating explanatory notes detail the political, philosophical, economic and tax policy rationales for implementing the Belgium ACE-variant, and the anticipated impact of this reform.

However, it is also important to recognise that Belgium did not have wide political support for the NID reform; indeed, the green and socialist parties opposed the NID, which was criticised as being used as “a weapon in the election campaign of 2004”. Further, the rationale of highlighting the urgency of the NID in light of the dramatic decline in investment in Belgium was criticised in the parliamentary debates as a rushed and underhanded political strategy. Despite ongoing political debate for over one year, which resulted in limitations to the NID, there were only 2 parliamentary sittings, which was criticised as resulting in insufficient debate on the broader reform of corporate

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70 Chambre des Représentants en Belgique, Compte Rendu Intégral avec Compte Rendu Analytique Traduit des Interventions – Belgische Kamer van Volksvertegenwoordigers, Integraal Verslag met Vertaald Beknopt Verslag van de Toespraken (Belgium) [House of Representatives, Full Report with a Summary Record of Translated Interventions], 22 June 2005, Paragraph 15.02, 59.
71 Chambre des Représentants en Belgique, Compte Rendu Intégral avec Compte Rendu Analytique Traduit des Interventions – Belgische Kamer van Volksvertegenwoordigers, Integraal Verslag met Vertaald Beknopt Verslag van de Toespraken (Belgium) [House of Representatives, Full Report with a Summary Record of Translated Interventions], 22 June 2005, Paragraph 15.12, 59.
income tax. This was considered especially problematic by opposition parties, who made comparisons to the reform processes in neighbouring countries such as The Netherlands.

Nonetheless, the parliamentary debates indicate that a large majority of the committee subscribed to the philosophy underpinning the reform, with the proposal receiving generally positive feedback and unconditional approval by the VLD (Flemish liberal party). However, the design parameters had mixed reviews; some parliamentarians believing the design was too generous and others considering it inadequate. The Finance Minister Didier Reynders interpreted this as indicating that the Bill was balanced, and earmarked an evaluation period to identify areas for improvement. At its inception, this Bill was touted as a pioneer in tackling tax discrimination between debt and equity finance.

Leading members of the National Bank of Belgium (the central bank of Belgium) have observed:

“The memorandum put to the Parliament stresses the neutrality property of the reform because it enables corporate income tax to overcome the well-known debt equity bias. It ends by indicating that the reform also provides an alternative for financial companies using the coordination centre regime. Most would argue – rightly – that of the two motivations the

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72 Chambre des Représentants en Belgique, Compte Rendu Intégral avec Compte Rendu Analytique Traduit des Interventions – Belgische Kamer van Volksvertegenwoordigers, Integraal Verslag met Vertaald Beknopt Verslag van de Toespraken (Belgium) [House of Representatives, Full Report with a Summary Record of Translated Interventions], 22 June 2005, Paragraph 15.12, 59–60.

73 Chambre des Représentants en Belgique, Compte Rendu Intégral avec Compte Rendu Analytique Traduit des Interventions – Belgische Kamer van Volksvertegenwoordigers, Integraal Verslag met Vertaald Beknopt Verslag van de Toespraken (Belgium) [House of Representatives, Full Report with a Summary Record of Translated Interventions], 22 June 2005, Paragraph 15.01, 53.

74 Chambre des Représentants en Belgique, Compte Rendu Intégral avec Compte Rendu Analytique Traduit des Interventions – Belgische Kamer van Volksvertegenwoordigers, Integraal Verslag met Vertaald Beknopt Verslag van de Toespraken (Belgium) [House of Representatives, Full Report with a Summary Record of Translated Interventions], 22 June 2005, Paragraph 15.01, 58.

75 Chambre des Représentants en Belgique, Compte Rendu Intégral avec Compte Rendu Analytique Traduit des Interventions – Belgische Kamer van Volksvertegenwoordigers, Integraal Verslag met Vertaald Beknopt Verslag van de Toespraken (Belgium) [House of Representatives, Full Report with a Summary Record of Translated Interventions], 22 June 2005, Paragraph 15.01, 58–59.
second was the more important and the neutrality properties are more a consequence of the reform than its main policy motivation”.78

When it was introduced, Finance Minister Didier Reynders and Prime Minister Guy Verhofstadt organized roadshows in Asia, the United States, and India to promote the NID. They were accompanied by representatives of some banks and tax advisory firms who explained how the NID could be used for group finance companies and treasury centers, for acquisition structures, and for post-acquisition restructuring.79 Subsequently, many multinational corporations moved their corporate treasury centers to Belgium, including for example the Dutch Randstad Group.80

During their roadshows, Finance Minister Didier Reynders and Prime Minister Guy Verhofstadt explained that the deduction reduced the corporate income tax rate from 33.99% to about 26%.81

It is important to recognise the context to these statements. Even though the official tax rate has fallen over 7% in 3 years, the effective tax rate at the time was over 21% higher than the EU average, as noted in the explanatory memorandum.82 The extrinsic materials also indicate that parliamentarians made reference to the Forbes suggestion that Belgium had the 3rd highest marginal tax rate in the world; cited as support for the proposition that Belgium’s tax rates were high and corporate investment and economic stimulus was in need of bolstering (taking into account considerations of economics and taxation). Further, the parliamentary debates refer to the high unemployment rate as an

82 Chambre des Représentants en Belgique, Compte Rendu Intégral avec Compte Rendu Analytique Traduit des Interventions – Belgische Kamer van Volksvertegenwoordigers, Integraal Verslag met Vertaald Beknopt Verslag van de Toespraken (Belgium) [House of Representatives, Full Report with a Summary Record of Translated Interventions], 22 June 2005, Paragraph 15.20, 62.
economic problem with NID presented as a strategy to lowering corporate tax and giving the Belgian
economy a new impetus.\textsuperscript{83}

Budgetary issues generally tend to pose one of the most significant political hurdles to implementing
fundamental tax reform. Even though the budgetary cost of the NID was a significant issue, the
government mentioned that it expected a €58M return on the NID reform.\textsuperscript{84} This was despite the
revenue cost of €566M, which was largely accepted by parliament, with budgetary compensation
measures and savings provisions (including abolishing corporate tax credits and opting-in to NID at
the expense of opting-out of “investment reserve” provisions) amounting to €400M. The extrinsic
materials make reference to the following 10-point benefits of the NID, anticipating that the NID
would incentivise equity finance thereby encouraging investment; facilitate employment; stimulate
financing; reduce bankruptcy risk thereby improving credit ratings; anchor investments in Belgium
thereby reducing relocation risk; stimulate the establishment of new companies; ensure consistency
with EU guidelines thereby providing the necessary legal certainty; facilitating an attractive
investment climate; improve competitiveness of Belgium;\textsuperscript{85} and facilitate private corporations’
investment in construction and property through equity finance.\textsuperscript{86}

The parliamentary debates highlight the criticisms in the design of the NID. For example, one of the
major obstacles to the implementation of NID was contained in Article 9; which barred companies
from distributing the portion of their profits that corresponds to the NID deduction by way of a


\textsuperscript{84} Chambre des Représentants en Belgique, Compte Rendu Intégral avec Compte Rendu Analytique Traduit des Interventions – Belgische Kamer van Volksvertegenwoordigers, Integraal Verslag met Vertaald Beknoopt Verslag van de Toespraken (Belgium) [House of Representatives, Full Report with a Summary Record of Translated Interventions], 22 June 2005, Paragraph 15.01, 53.

\textsuperscript{85} Chambre des Représentants en Belgique, Compte Rendu Intégral avec Compte Rendu Analytique Traduit des Interventions – Belgische Kamer van Volksvertegenwoordigers, Integraal Verslag met Vertaald Beknoopt Verslag van de Toespraken (Belgium) [House of Representatives, Full Report with a Summary Record of Translated Interventions], 22 June 2005, Paragraph 15.02, 55.

\textsuperscript{86} Chambre des Représentants en Belgique, Compte Rendu Intégral avec Compte Rendu Analytique Traduit des Interventions – Belgische Kamer van Volksvertegenwoordigers, Integraal Verslag met Vertaald Beknoopt Verslag van de Toespraken (Belgium) [House of Representatives, Full Report with a Summary Record of Translated Interventions], 22 June 2005, Paragraph 15.02, 59.
dividend unless they retained an amount equal to the amount of the NID deduction for a period of at least four years. In the extrinsic materials prepared in June 2005, one of the key anti-abuse mechanism contained in Article 9 was reduced to 3 years following concerns that 4 years would make equity less appealing than debt finance and could undermine the effectiveness of the NID. Even though the design was the subject of passionate political debate and was ultimately a compromise, the parliament considered that Article 9 should be further relaxed in subsequent legislative amendments. Nonetheless, this provision was amended even before the commencement date of the NID; with the Belgian Prime Minister Guy Verhofstadt delivering a public announcement on 17 November 2005 that this obstacle to the NID would be lifted. While this revision arguably aligned the NID more closely to its theoretical underpinnings in the ACE, it is largely an administrative issue rather than one of tax policy design which encourages the use of equity financing at the risk of making the system more vulnerable to abuse from aggressive tax planning. The key criticism was that the NID was largely agreed to in principle, but the provisions and administrative aspects were unnecessary to the point that it was criticised as largely missing its objectives in practice. This highlights how translating ACE theory into practice through a robust tax reform design is one of its most challenging aspects, as anticipated by the wider ACE literature and as experienced by jurisdictions in the past.

87 Parliamentary reports show dialogue such as “Mr. Bogaert, I suggest that you take the sequel to the market stand, because you are very good at selling apples that look like pears.” Chambre des Repräsentanten en Belgique, Compte Rendu Intégral avec Compte Rendu Analytique Traduit des Interventions – Belgische Kamer van Volksvertegenwoordigers, Integraal Verslag met Vertaald Beknopt Verslag van de Toespraken (Belgium) [House of Representatives, Full Report with a Summary Record of Translated Interventions], 22 June 2005, Paragraph 15.02, 57.

88 Chambre des Repräsentanten en Belgique, Compte Rendu Intégral avec Compte Rendu Analytique Traduit des Interventions – Belgische Kamer van Volksvertegenwoordigers, Integraal Verslag met Vertaald Beknopt Verslag van de Toespraken (Belgium) [House of Representatives, Full Report with a Summary Record of Translated Interventions], 22 June 2005, Paragraph 15.52, 69.


90 Chambre des Repräsentanten en Belgique, Compte Rendu Intégral avec Compte Rendu Analytique Traduit des Interventions – Belgische Kamer van Volksvertegenwoordigers, Integraal Verslag met Vertaald Beknopt Verslag van de Toespraken (Belgium) [House of Representatives, Full Report with a Summary Record of Translated Interventions], 22 June 2005, Paragraph 15.20, 64.


92 The ACE-variant adopted in Brazil is more akin to a system of dividend deductibility; see further, Klemm A, Allowances for Corporate Equity in Practice, IMF Working Paper WP/06/259, 24.
Separately, there was political opposition to the limited scope of the NID, which some parliamentarians argued ought to be extended to personal income tax. This reflects the ACE literature, which anticipates that one key challenge in designing and implementing ACE reform is that it does not operate as a backstop to the personal income tax system. Even though leading commentators have suggested that tax neutrality cannot be achieved unless there is a personal level ACE, the domestic shareholder position is less relevant in a small, open economy where the marginal investor is likely to be a foreign investor. While it is difficult to pinpoint the non-resident investor as the marginal investor, it is plausible for a small, open economy like Belgium.

3.1.2 NID: SUBSEQUENT AMENDMENTS & ECONOMIC, POLITICAL AND ADMINISTRATIVE ISSUES

The NID has been continually amended by the Belgian parliament since its introduction in 2005, culminating in the continued reduction in the NID rate and the abolition of carry-forwards further limiting the scope of the NID. These two legislative changes have taken the NID further away from its original legislative purpose and underlying ACE principles. First, reducing the tax deduction provided for equity financing risks eliminating the neutrality properties of the ACE and simply providing a sweetener for equity financing; and second, abolishing carry-forwards exacerbates the asymmetric treatment of profits and losses.

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93 Chambre des Représentants en Belgique, Compte Rendu Intégral avec Compte Rendu Analytique Traduit des Interventions – Belgische Kamer van Volksvertegenwoordigers, Integraal Verslag met Vertaald Beknopt Verslag van de Toespraken (Belgium) [House of Representatives, Full Report with a Summary Record of Translated Interventions], 22 June 2005, Paragraph 15.11, 58.
97 Belgium has been recently described as a small, open economy by economists; see, for example, Du Caju P, Rycx F and Tojerow I, ‘Wage structure effects of international trade in a small open economy: the case of Belgium’ (2012) 148(2) Review of World Economics 297.
However, when considering any subsequent legislative amendments to the NID reform, a holistic understanding of the political landscape is an imperative starting point. Since 2007, Belgium was confronted by an ongoing political crisis at federal level.\textsuperscript{100} During that time, the outgoing conservative/socialist government continued to handle current affairs, and in October 2007, following much political pressure, decided to conduct an investigation into alleged abuses by Belgian companies and Belgian banks of the NID.\textsuperscript{101}

A key political issue in practice is that the NID is thought to benefit the larger multinational corporations ("MNCs") more so than SMEs. This is because the larger MNCs are able to put substantial amounts of equity capital into their treasury arms or internal finance companies thereby eroding their corporate tax base.\textsuperscript{102} This challenges whether the NID is genuinely beneficial for the domestic economy or whether it presents a tax break for the most profitable MNCs who are able to tax plan and bypass anti-avoidance rules and maintain very low effective tax rates. However, leading practitioners and economists observe that the NID also benefit SMEs by incentivising business capitalisation and thereby protecting businesses during the GFC.\textsuperscript{103} Further, it is arguable that this is an obvious feature of the NID which is why it was such an attractive investment reform to begin with. Some legal practitioners have observed that "the purpose of introducing the notional interest deduction was just to make Belgium fiscally attractive to foreign investors and to offer a credible and competitive alternative for the coordination centres whose system was condemned by the European authorities".\textsuperscript{104} Indeed, it is arguable that since the NID resulted in substantial investment by both local and overseas MNCs, it thereby encouraged a larger capital base, which ensured that those companies were well-positioned to withstand the GFC because of their capital buffers.

Nonetheless, the pressure from lobby groups and media sentiment that MNCs were unfairly advantaged by the NID remains substantial. By way of background, SMEs and MNCs currently have an average tax rate of approximately 34% and 5% respectively. This has resulted in industry lobby groups such as Le Syndicat des Indépendants & des PME calling for reform to the NID to “reconcile the existing blatant discrimination between hundreds of small SMEs that pay 3-4 times more taxes that multinational companies”.¹⁰⁵

The following example demonstrates how MNCs were able to dramatically lower their tax bases; a MNC will establish an internal bank in Belgium and will then provide inter-company loans. If the NID deduction is, for example, 3% and the interest rate charged by the MNC on its inter-company loan is 3.5%, then corporate tax on the finance company’s net interest income is reduced to 0.5%.¹⁰⁶

Political concerns regarding aggressive tax planning led to the broadening of Belgium’s thin capitalisation rule, which specifically targets inter-company loans with a 5:1 debt to equity ratio limitation. Further, subsequent explanatory notes¹⁰⁷ reveal a link between the reduced scope of the NID and the increased incidence of thin capitalisation rules in Belgium. The relationship between reducing the scope of the ACE-variant and the increased implementation of thin capitalisation rules in Belgium suggests an inversely proportional relationship between these two reforms which has not been addressed in the English-language literature. Future research by the author will explore this aspect in further detail.

¹⁰⁶ This highlights that the use of intra-group finance companies poses key technical issues for ACE-based reforms in this area, and will be a significant aspect of future research by the author.
¹⁰⁷ La Chambre des représentants de Belgique – Belgische Kamer van volksvertegenwoordigers [Senate Explanatory Notes], Project de Loi-Programme du 24 février 2012 – Ontwerp van Programmawet van 24 februari 2012 (n° 53-2081/001), Art 139, 94–98 (Belgium).
This presents arguably the most substantial hurdle to implementing and sustaining ACE-based reform; it is politically very difficult to quantify (and therefore justify) the benefit of the NID and very easy to point to the loss of revenue; for example, in Belgium €3–4 billion is claimed in NID deductions annually. However, in an increasingly globalising economy with capital mobility there is no certainty that regulatory tightening will prevent a loss of revenue. Belgium’s thin capitalisation rules are relatively lenient. Even so, many MNCs are now moving out of Belgium as a result of the overall regulatory tightening including inter alia tightening thin capitalisation rules, increasing interest withholding tax rates, tightening anti-abuse rules and levying CGT on shares.

So, even though MNCs were subject to relatively low effective tax rates under the NID reform it is conceivable that this at least incentivised businesses to operate from, and develop in, Belgium – this influx in inbound investment may have, in turn, had a multiplier effect.

Nonetheless, the most significant political pressure point and media criticism of Belgium’s NID is in relation to its cross-border impact; specifically, the tax avoidance opportunities that it presents for MNCs. However, policymakers are unable to deliver targeted reform in the cross-border context due to EU anti-discrimination law. This exemplifies the impact that politics has on tax policy developments and practice, most recently culminating in the European Court of Justice determining on 4 July 2013 that the NID rules and in particular the refusal to apply the NID to a foreign permanent establishments' net assets violates the freedom of establishment.108 It goes without saying that this resulted in the Council of Ministers resolving to amend the legislative provisions within 3 months of the judgment of the European Court of Justice.

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Over the past few years, there has been increased media pressure and pressure from all sides of politics to abolish the NID. This has resulted in the NID becoming a Federal election “hot topic”, with the election scheduled to be held on 25 May 2014.109

Media reports indicate that political parties such as the Christian democratic party Centre démocrate humaniste (CDH) are promising to abolish the NID as part of their election campaigns:

“The gain for public finances would be reinvested without waiting for the new term in a decrease of 10 per cent of the corporate tax rate, benefiting all, whether SMEs, TPE or independent ... This reform that we can carry out without delay ... deleting a liberal but also socialist mismanagement ... Notional interest for everybody, right now: SME, SOHO and independent.”110

It goes without saying that the tax policy uncertainty from first implementing, then modifying, phasing down, and now considering the abolition of the NID erodes business confidence. Leading practitioners agree that abolishing the NID will diminish the attractiveness of Belgium as a destination for inbound investment:

“It is therefore true that the notional interest deduction has allowed many companies to reduce their taxable result, but that is precisely the goal that is pursued, with full knowledge of the facts, by the political parties that were at the origin of the construction and of which some criticize the construction heavily today ... This constant legal uncertainty incites some companies to seek calmer climes, sometimes by establishing themselves at just a few miles from our borders, this to the detriment of competitiveness, the economy and the image of Belgium on the international stage. This is of course regrettable.”111
It remains unclear whether the NID will be abolished, with industry groups and practitioners awaiting further developments in the months following the 2014 Federal election.
3.2 ITALY

Prior to 1997, the Italian corporate income tax system, which was designed as a full imputation system, had not been subject to major reforms for nearly three decades. However, by 2004, Italy transitioned from an imputation system to a classical system, with a participation exemption regime introduced to mitigate double taxation of corporate profits. Italy’s move away from an imputation system is in line with many other EU member countries.

Italy provides a unique and interesting case study because it has implemented two ACE-variants under two different corporate-shareholder tax systems. First, the ACE-variant operating in Italy from 1998–2001 termed the Dual Income Tax (“DIT”). Although inspired by the Nordic DIT, Italy’s DIT was very different as it only affected capital income. This has leading commentators describing it as “the most confusing name”. Companies were liable to pay the statutory corporate income tax rate on above-normal profits; with the normal return on capital subject to a reduced tax rate fixed by the government; a nominal return on capital calculated by reference to the average interest rate on bonds plus a risk premium.

Second, the new ACE implemented in 2012, termed the Aiuto alla Crescita Economica (“Italian ACE”). Leading commentators observe that the Italian ACE shares the main characteristics of the theoretical ACE. The Italian tax system also has elements of CBIT due to the local business tax, the IRAP, and also because of the limit to the deductibility of interest, in force since 2008. Accordingly, the Italian corporate income tax system can be characterised as combination of a partial ACE and a partial CBIT, thereby mitigating the debt-equity distortion from both directions.

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113 “Effective for tax periods starting on or after 1 January 2004, Italy applies a classical system of taxation of corporate profits. The former imputation system is abolished and replaced by a 95% participation exemption for corporate shareholders and a 60% exemption for individual shareholders who hold the participation in a business capacity. Individual shareholders not holding the participation in a business capacity are also entitled to the 60% exemption if they own more than 2% of the voting power or 5% of the capital in listed companies, or more than 20% of the voting power or 25% of the capital in other companies (substantial participation). Otherwise, dividends derived by individuals are subject to a final withholding tax at a rate of 12.5%.”; see further, Uricchio A, Italian Individual Taxation, available at: www.lex.uniba.it/ta/ITALIAN_INDIVIDUAL_TAXATION.ppt.


3.2.1 DIT: POLITICAL HURDLES TO IMPLEMENTATION
An understanding of Italy’s political dynamics is imperative in assessing tax policy reforms. Originating from a context of taxpayer discontent and widespread tax planning and tax evasion, the then centre-left government introduced the DIT as part of its “Visco” reforms. The relevant extrinsic materials detail the DIT was introduced to encourage greater neutrality in corporate financing decisions and facilitate competitiveness by making Italian an attractive investment destination.116

3.2.2 DIT: SUBSEQUENT AMENDMENTS & ECONOMIC, POLITICAL AND ADMINISTRATIVE ISSUES
Revenue neutrality concerns resulted in two key restrictions being placed on the original DIT which reduced its initial effectiveness.117 First, the opportunity cost of equity finance was not deductible from taxable income, rather it was taxed at a reduced rate; and second, only post-reform equity is considered in DIT deduction calculations under an incremental approach (similarly to the Belgian NID).

While leading academics observed that over time, the second restriction would not be problematic in the long-term, the short-term political repercussions were significant. The DIT was criticised as largely benefiting large and profitable firms, who were more likely to issue new equity, while companies in the South and SMEs were less likely to issue equity, despite their higher cost of debt.118 This runs contrary to ACE theory, which anticipates that the ACE would increase the tax burdens on the most profitable firms and encourage innovation by SMEs by lowering tax burden on marginal projects.

One of the key legislative amendments that aligned the DIT more closely to the original ACE was the recognition by parliament that both personal and corporate income tax may need to be reformed in

tandem to prevent inefficiencies in the type of organisational form. This culminated in the reorganization of the personal income tax in order to facilitate the capitalisation of companies.

In any event, it is arguable that the technical and social teething process suggests that the transition to the DIT had not been completed, with Senate stenographic report indicating:\textsuperscript{119}

\begin{quote}
“We have also further strengthened the tools to support new investments, through the extension and improvement of the Visco reforms, and the extension and acceleration of the Dual Income Tax ... its complexity both from a technical point of view and from a social impact, required a long preparation ... 2000, therefore, should reap the benefits of this long preparatory phase.”
\end{quote}

The DIT was a restricted version of the standard ACE, subject to “an excess of changes”\textsuperscript{120} and complicated interactions with other taxes, resulting in leading academics observing that this rendered both theoretical and empirical analysis difficult.\textsuperscript{121}

It is noteworthy that this reform package was not fully completed due to the change of the government’s coalition following elections in 2001, which resulted in the repeal of the DIT in favour of a single-rate corporate tax scheme. Leading commentators have observed that, interestingly, the abolition of the DIT resulted in a higher tax burden for most companies.\textsuperscript{122} Further, administrative issues surrounding the continued ‘reform of the reform’ resulted in a detrimental level of uncertainty.


\textsuperscript{121} Klemm A, Allowances for Corporate Equity in Practice, IMF Working Paper WP/06/259, 6–9.

which stunted growth, with leading commentators highlighting the “need for stability and completion of reforms for greater coherence and rationality of the system”.\textsuperscript{123}

### 3.2.3 ITALIAN ACE: POLITICAL HURDLES TO IMPLEMENTATION

Parliamentary transcripts provide detailed insights into the political spectrum and background rationales for why the Italian ACE was implemented in the midst of a recession.\textsuperscript{124} Specifically, parliamentarians from centrist parties observed in the explanatory materials that “today’s speakers' clearly witness the change in the political phase, which led to the opening of scenarios that seemed unthinkable just a few months ago”.\textsuperscript{125} There is specific reference to fact that the new reforms such as the Italian ACE are “owing to the heterogeneity of the coalition forces supporting it ... the Decree-Law is only justified in light of this particular political and institutional framework.”\textsuperscript{126}

This political solidarity culminating in the legislative reform under pressure of a “very dangerous” economic situation appears to have resulted in a renewed confidence in the Italian financial markets; “the political stability provided by the new government has had a positive impact on the financial markets with a reduction in the order of 200 points on the yield spread between Italian government bonds and German ones”.\textsuperscript{127}


The Italian ACE was introduced to stimulate the capitalisation of companies by reducing tax on income from capital funding risk; reduce the imbalance in the tax treatment between companies that are financed with debt and companies that are financed with equity, thereby strengthening the capital structure of Italian companies; and to encourage, more generally, the growth of the Italian economy.

However, the Italian ACE was not implemented without political opposition. Parliamentarians from opposition parties such as Il Popolo della Libertà (Christian democrat party launched by Silvio Berlusconi) commented that the national and international press were talking about the Italian situation in alarmist terms and observed that “real growth in Italy is likely to be negative for a long time”. The Italian ACE was also strongly opposed by regionalist minority parties such as Lega Nord Piemont, who believed that this reform would further depress growth, especially in their electoral areas in the North.

As originally drafted, Italian ACE invokes the DIT in some respects. A substantial improvement on the Italian ACE is that, while the DIT incentivised capitalisation by applying a reduced rate to the portion of profit identified by the notional return on capital, the Italian ACE provides a tax deduction in respect of the notional return on new equity. Further, the Italian ACE was introduced with...
retroactive effect, or to also apply for the whole of 2011. This ensured the Italian ACE was more closely aligned to the original ACE principles, directly and immediately allowing deductions for equity financing and not providing an upper limit to the increases in equity financing. Importantly, the Italian ACE also applies to corporations, individual firms and limited partnerships, the inclusion of which promotes neutrality in organisational form.

3.2.4 ITALIAN ACE: SUBSEQUENT AMENDMENTS & ECONOMIC, POLITICAL AND ADMINISTRATIVE ISSUES

While the Italian ACE is still in a relatively early stage, authoritative commentators praise the reform as a comprehensive package consistent with preventing MNCs from undercapitalising their Italian operations. Indeed, the introduction of the Italian ACE has not led to the modification of Italian rules on the deducibility of interest. Currently interest barrier rules are in place instead of thin capitalisation rules, whereby the limitation of interest deductibility is now based on an operating income test, rather than debt-to-equity ratios.

An equally promising development was announced in October 2013, with the government releasing a list of measures it intends to implement to make Italy more attractive for foreign investors and to strengthen business conditions. Most relevant is Measure 19, which proposes the introduction of the “super ACE”, which targets companies intending to go public. Although there is currently little detail surrounding this proposal, the government has announced that the “approach would be the same used in the current ACE, which enhances a company’s cost-effectiveness and ‘transparency’ after

135 Assonime, ‘La disciplina dell’ACE (aiuto alla crescita economica)’ (Direct Taxation, Circular No 17, 7 June 2012).
It will be very interesting to observe whether this reform is implemented and, if so, whether in practice it more closely aligns the Italian ACE to the original ACE principles.

Operationally, the new benefit results in a deduction from the total income of an amount corresponding to the notional return of new equity. This return, for the first three years of application of the rule (2011-2013) is fixed at 3%; however, from the fourth tax year (2014), this rate is determined by decree of the Minister of Economy and Finance to be issued by January 31 of each year, taking into account the average financial returns of public bonds, which may be increased by a further percentage point to more closely align with the risk-free nominal return (10-year Italian government bonds are currently returning approximately 4%, down from 6.5% in 2012).

Accordingly, 2014 will pose an interesting year for observing the developments to the Italian ACE, especially following the emergence of media reports in mid-December 2013 that the Italian political situation is once again heading towards political uncertainty.

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4 CONCLUSION

This paper identifies four key recurring trade-offs that present political challenges to the implementation of ACE-variants throughout its analysis of the Belgian and Italian experiences. Interestingly, these trade-offs are themes anticipated in the ACE literature. First, the trade-off between revenue neutrality and ACE system integrity. Second, the trade-off between implementing an ACE (at the expense of tax revenue) as opposed to reducing the headline corporate income tax rate. Third, on a domestic level, that politically the ACE is perceived to benefit MNCs disproportionately more so than SMEs. Fourth, on an international level, that there is a trade-off between the desire to make inbound investment more attractive and the risk of base erosion from aggressive tax planning by MNCs.

Accordingly, these trade-offs may provide a useful reference point for Australian policy makers’ future considerations of ACE reform. The author will be conducting further research in this area in order to present a legal analysis of how ACE may be applied in the Australian context with specific reference to cross-border issues.