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Tax Competition and Investment in the EMU: The Case of the Cash Flow Income Tax in Greece

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Abstract

This paper addresses the issue of the urgent need for the capital income tax restructuring in Greece in order the country to meet its recent exposure to the EMU tax competition (as accentuated by the economic globalization). The unsuccessful income tax harmonization in the European Union (EU) has intensified tax competition among the member countries, entailing reduction of effective tax rates. Such a tax competition is an inescapable policy for the countries adhered to the basic structure of income tax as internationally applied. However, this is quite painful for countries of high taxation and public debt, like Greece. On the other hand, the fundamental restructuring of the Greek income tax towards the Cash Flaw Income Tax, effected on the basis of equal revenue yield, seems to offer the country the necessary tax competitive advantage against the competitors in the EMU. Under such restructuring, the domestic or imported income and profits invested in Greece will be dispensed with the indigenous equity and efficiency deficiencies of the current tax system (since they will be relieved of any tax burden), thus making the economy attractive of funds on a tax induced basis (without discriminating between current and future consumption). To this end, the paper examines the relative merits of such a policy in the domestic and international setting of Greece, purporting to constitute a starting point for a thorough examination in this respect.

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1. Introduction

Income taxation in Greece has experienced systematic Governments' interventions mainly as the most effective means of raising revenue. In the last decade, these interventions were intensified under a strict fiscal policy implementation, necessary for securing country's entrance to the EMU. Notwithstanding the fact that, in many instances, income tax interventions constituted major reforms, these, striking more at the level and distribution of the burden and the compliance and enforcement requirements and less at structural aspects, were lacking the fundamental reform trait and typically conceived in closed-economy settings.[1] Be that as it may, the gradual openness of the Greek economy in the 1990s, and especially the liberalization of all its capital flows within the frame of EMU since 2000, suggests that the income tax is likely to succeed only if it is tailored to the international situation of

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[1] Zacharopoulos K. (1999).

the Greek economy. Such a tailoring has nowadays turned to be most urgent than ever, given the tax competition environment prevailing in the EU, as a result of the unsuccessful attempts to harmonizing or coordinating the Member-States income tax, and the intensity of such competition, as volumes of international financial flows and of cross border savings are increasing rapidly. The introduction of the Euro removes currency risks and differences in interest rates within the EMU. Tax differences will be the main remaining issue to be resolved. For Greece to stand successfully in such a demanding environment, presupposes fundamental income tax reform with special impact on the international and predominantly in the EU setting. Any other approach, of the kind of reciprocating or responding to the other Member-States competing tax arrangements, will be a beggar-thy-neighbor policy which may be followed by fiscal degradation.[2]

To this end, the paper identifies, examines and formulates such a radical tax reform within the basic structure and function of the cash-flow income tax. It is concluded that the Cash-Flow Income Tax allows scope for Greece to gain a sustainable competitive advantage placing it ahead of the other Member-States of the EU. This model will promote the fairness, efficiency and administration of the income tax system of Greece on the domestic and international level.

2. The Concept of Fundamental Tax Reform: Comprehensive versus Cash-Flow Income Tax

Any tax reform contemplation should be based on an ideal tax system against which proposals can be evaluated. Disagreements on the nature of the ideal tax system encompass the most fundamental issue for levying taxes, that of the fairness in taxation. Fairness dictates that persons with the same ability to pay should bear the same tax burden. If this condition is violated problems will be created from equity, efficiency and administrative standpoints. The debate ranges over income and consumption as alternative measures of individual's ability to pay in their ideal forms, and particularly between Comprehensive Income tax (CIT) and Cash Flow Income Tax (CFIT) respectively.

The Evolution of the Worldwide Income Tax Reform

From the outset of 1970s and hence, the Expenditure Tax has been progressively established as one of the two models or ideals for evaluating income tax policy,[3] the other being the Haig-Simons accretion ideal or Comprehensive Income Tax. The major tax reform in the western countries, which started from the Tax Reform Act of 1986 in USA and swiped in Europe, sought to broaden the base and lower the rates of the existing personal and corporate income taxes. This reform was not necessarily fundamental, in the sense of succeeding to implement to a satisfactory extent the structure of the Comprehensive Income Tax.[4] In the end, the potential gains of such a reform were not enough to cancel the renewal interest

[2] Tanzi Vito (1995), p.7.

[3] US Department of the Treasury (1977); Lodin, S.O. (1978); Meade J. E. (1978).

[4] Pechman J. A. (1988).

in fundamental tax reform, but this time in the direction towards the Expenditure Tax ideal.[5] The current national systems of income taxation are often criticized as variably falling off the generally acceptable goals of taxation, and particularly as being, to a lesser or greater extent, administratively complicated, depressive of saving and enterpreneurship (and consequently of growth) and inequitable.[6] This criticism keeps up the controversial issue of whether the principal innate traits of the progressive income taxation have the potential to meet, in a balanced way, the generally acceptable goals of taxation, or alternatively depart in practice from the norm as the less-worst choice to this effect.

On the other hand, implemented or contemplating tax reforms, whether fundamental or not, are with reference mostly to domestic goals of the nations concerned. However, as economies are exposed to the rest of the world the attainment of these goals becomes pervasive under the increasing impact of international considerations.

The Comprehensive Income Tax in Theory and Practice

The comprehensive income reflects the economic spending power in a period, expressed either in terms of its uses (i.e. as an outflow), comprising consumption plus all net accrual to wealth (real saving), or in terms of its accretion (as an inflow), encompassing all forms of return to human and non-human (real and financial) capital, including changes in the value of capital.[7] The latter one, which constitutes the functional version of comprehensive income concept, comprises, in real terms (thus calling for inflation adjustment)[8]: a) the conventional forms of income, (such as receipts, wages, salaries, interest, dividends, profits, rents, royalties, etc); b) the net appreciation of capital ownership (whether realized or not), provided that appropriate allowance is made for averaging and loss offset; b) gifts and bequests; c) corporate source income (in the form of integration), whether distributed or not; and d) imputed rent of homeowners, combined with deduction of depreciation and mortgage adjustment. This concept of personal income, particularly theoretical, includes receipts from all possible sources which reflect taxable capacity. These receipts, summed up under a common unit of spending power, constitute the taxable base which is subjected to a progressive scale of tax rates.

However, the application of this concept in practice presents particular problems reflected in numerous violations of its constituent principles in national income tax legislations. One important area in which national legislations violate the principles of the ideal system concerns the treatment of capital income. Four problems in this respect are central. The first refers to the requirement for inflation adjustments of the constituent elements of the income tax base (and especially the real economic depreciation, inventory costs, capital gains, and interest income and expenses), and of the income slices of the progressive tax rate schedule. Although administratively complex and burdensome, this will protect the equity and efficiency of the tax system.

[5] Aaron Henry (1997).

[6] See footnote 5.

[7] Haig J. R. (1921); Simon H. C. (1938).

[8] Musgrave R. (July-August, 1976), p.5.

The second concerns the thorny practical difficulties in measuring the accrual (not realized) capital gains in the absence of objective market prices for numerous assets. This gives rise to the conflict between the ideal and applied concept of income, which is responsible for much inequity, inefficiency, and complexity. The third is the unequal treatment between current and future consumption, which, resulting from the annual taxation of the capital income, discourages the latter, with far-reaching repercussions on the efficient allocation of recourses and growth. The forth concerns the definitional mandate for integrated corporate and personal taxation, which is violated in practice by the separate taxation of corporate income, for different reasons, among which is the avoidance of the potential deferral of tax on profits until distributed. This violation is accountable for double taxation of distributed profits, and unequal treatment between corporate and unincorporated businesses. Finally, the asymmetry of the capital income taxation, stemming from the unequal treatment of saving, and the subjection of the various categories of income under a common denominator to the progressive tax rate schedule, is accountable for the separate taxation of various categories of capital income and the numerous exemptions, credits and deductions, through which the governments try to support such desirable activities as particular business investments, homeownership, and retirement saving.

The Cash Flow Income Tax

On the other hand, the base of expenditure tax can be obtained from the comprehensive income as the accretion of economic spending power in a period, minus or plus the increase or decrease of the taxpayer's net worth in the period respectively, i.e. income less net saving or plus net dissaving. An expenditure tax is usually described as a tax on personal consumption, most suitably computed by the cash flow technique. This means that income and expenditure cash flows are taken into account for each period, while changes in wealth due to changes in the value of individual assets do not affect tax liability. Assets do not have to be valuated. No effect appears on the annual tax return until an asset is converted into liquid holdings. Thus, unlike income tax, which is result oriented, expenditure tax is liquidity oriented. Use of the cash surplus forms the tax base. In this respect, purchases of financial assets would be deducted and subsequent earnings and withdrawals of principal for consumption purposes taxed (see table A, column 2). This *cash flow treatment* of assets is equivalent, in present value terms, to the *tax prepaid or yield exemption treatment,* under which no deduction would be allowed for purchases of assets but earnings and withdrawals of principal would be exempt from tax. Similar flexibility would be granted for loans (see table A, column 3). Deferral of tax in the present leads to payment of the same tax plus interests when the asset is sold for consumption. However, the payment of taxes occurs later under the cash flow method which allows a savings deduction than under the method which allows an interest exemption.[9]

[9] In a world of certainty, if all income is consumed over a lifetime and there is no tax on saving and no gifts or bequests, the present value of the lifetime consumption expenditures of two persons with the same lifetime income (also discounted to the present) is the same regardless of when they consume their incomes. Thus the expenditure tax has a lifetime perspective.

The Cash Flow Tax avoids the most difficult measurement problems of the comprehensive income tax mentioned earlier. In particular, inflation does not pose any problem for this tax (except for an adequate bracket indexation), because the calculation of the base involves only current year transactions. The tax base and the liabilities are always measured in consistent units. (Because all outlays for saving and investment would be fully deductible when they are made, there would be no deferred deductions to be eroded by inflation). There is no need for computing capital gains and depreciation charges, since the cost of capital from which they originate is fully deducted on acquisition. Such capital assets have a zero base on their acquisition, and the product of their disposal is taxed unless it is reinvested. There is, also, no need to discriminate between accrued and realized capital gains, since the accruals add equally to both the income and saving, where the former offsets the latter. Furthermore, returns to capital which take an imputed form, such as imputed rent on housing, need not be measured under the pre-paid treatment. Under the CFIT there is no discrimination between current and future consumption, consequently there are no distortions in the timing of consumption. This has the effect which is indeed the characteristic of the CFIT, that, at any given 'constant' marginal rate of tax, the (after tax) rate of return to the saver (from investing or lending his savings) in relation to the amount of his forgone (postponed) consumption is the same to the (before tax) rate of return on the underline loans or investments; whereas, under the income tax, the rate of return to the saver is set below the true yield of the loans or investments, thus canceling any tax induced incentive for taxpayers to substitute at the margin present consumption for future consumption (see table A. columns 1 and 2).[10] This difference is particularly important from an equity and an efficiency standpoint, as it becomes apparent in the case of a taxpayer who saving his current's year income X for n year, with constant annual yield r and marginal tax rate t, consumes the principal and the accumulated yields at the end of that period. Under these circumstances, his after-tax rate of return on his forgone consumption and his total consumption will be respectively $r(1-t)$ and $X(1-t)[1+r[1-t)^n]$ in the CIT regime and r and $X(1+r)^n(1-t)$ in the CFIT, where each item of the former is lower than the respective one in the latter.[11] The greater the n the greater the discrepancy of the total consumption between the two regimes.

Finally, under the CFIT the separate corporate tax looses importance, since the base of the tax does not by definition include funds until they are distributed and used for consumption. If, however, were desired to levy some charge on corporate activity as surveillance for the undistributed profits and for other reasons, this should be on the corporate cash flow. In particular, the corporate tax base would comprise receipts from all sources (as the sale of products and services), borrowed funds net of principal repayments, and interest received net of interest paid; less costs of materials and supplies, labor, and capital goods. Alternatively, the tax base may be estimated as payments out of the corporation to its shareholders, net of

[10] Meade J. F. (1978), p. 37; Goods Richard (1980), p.58.

[11] Zacharopoulos K. (1999), pp. 167-169.

funds received from shareholders through the issuance of new stock.[12] Cash flow generated by unincorporated business is similarly calculated, but it would be attributed directly to the owners of the business, as under current law, rather than taxed separately at the level of the business entity. Under such a cash flow corporate and unincorporated business profit tax, the rate of return on an entity's new capital development is not taxed unless the proceeds are distributed and not reinvested. For this reason such taxation is a suitable bedfellow for a personal expenditure tax. In particular, the post-tax rate of return to the investor is equal to the pre-tax rate of return on the underlying investment in real capital assets (see section 5). Under the personal and corporate cash flow, income taxes reduce or eliminate most distortions of saving and investment that would exist under even the most carefully crafted annual income tax.[13] Thus the cash flow system not only meets the requirements of fairness but also terminates tax-induced distortions in saving.

Corollary

Be that as it may, the current income tax in various countries is in some respects a cross between the Comprehensive Income Tax (CIT) and the Cash-Flow Income Tax (CFIT) ideals. Like a CIT, it taxes ordinary investment income, such as interest and dividends, and does not have any general deduction for saving. Like a CFIT, it fails to tax unrealized appreciation in value of assets, provides a number of particular deductions for items that realistically represent capital expenditures, and omits from taxable income returns on owner-occupied housing and consumer durables. The income tax applied in the industrialized countries does not go all the way in either of these directions.

3. General Principles of International Taxation

The Principles

International taxation relies on the following two principles: the *residence principle* according to which a country taxes the income of its residents, independently of the location of its source; and the *source principle* under which income is taxed in the country it arises, independently of the jurisdiction the recipient resides. Broadly, the former taxes a nation's savings and the latter taxes the income that arises from investments in it. However, the countries in practice tax both the foreign income of their residents and the domestic income of the foreigners. In a world in which both principles coexist, bilateral agreements for alleviating double taxation is necessary. The influential model treaties for most treaty negotiations between countries are that of OECD and UN ones. The former gives emphasis to the residence principle at the expense of the source principle, while the latter leaves to negotiations the capital income withholding tax rates of the source country paid out by foreigners.

[12] The equivalence of the two methods follows from the identity that all sources of funds to the corporation must equal all uses of funds.

[13] The cash flow income tax to be paid by business can have, beyond the tax on cash flow to individuals, a withholding tax on payments to foreign investors and companies (see section 5, below).

This explains why the developing countries (which are mainly importers of capital) prefer the UN model and the industrialized countries the OECD model (altghough even the last one is being questioning by those industrialized countries which has become a net importer of capital, like the USA).[14]

In any case, since the source country has the first opportunity to tax it is typically in the responsibility of the residence country to establish double taxation relief provisions. If, for the sake of clarity, the tax rate and the rate of return is respectively t_d and r_d at home, and t_f and r_f abroad, these provisions can take the form of: crediting the foreign tax against the domestic tax liability with the later one calculated on a tax base inclusive of the gross of foreign tax income from abroad (*tax credit method*), i.e. $r_f(1–t_d)$; or including the net of foreign tax income from abroad in the calculations of the domestic tax liability (*tax deduction method*), i.e. $r_f(1–t_f)(1–t_d)$; or exempting altogether the foreign income from the calculations of the domestic tax liability (*tax exemption method*), i.e. $r_f(1–t_f)$. Uniform adoption of either the credit or exemption method would eliminate the double taxation problem, although with different implications for efficiency, whereas, the deduction method does not eliminate the problem of double taxation but it can increase the national welfare of the capital exporting country (as mentioned below).

Three aspects of current practice lead to an effective application of source principle: credits of foreign tax in excess of the tax liability at home are not usually recognized, and as a result the residence countries refuse to pay out refunds thereof typically bearing the foreign source tax (*excess tax credit refusal*); no domestic tax becomes due on incomes arising abroad until they are brought home (typical case being the incomes of home companies operating abroad through subsidiaries), thus blunting the impact of home taxes (*tax deferral*); and, it is notoriously difficult to ensure that foreign source portfolio income (interest and dividends) is reported to the authorities of the residence country and does not evade home taxes, thus being only subjected to the source withholding taxes (tax evasion).

Efficiency Criteria

As a general proposition, the residence principle uniformly applying under a full credit provision (i.e. allowing refunds for any excess over the home tax liability) ensures *Capital Export Neutrality* (*CEN*). This is an efficient concept requiring that a resident of any particular jurisdiction face the same effective marginal rate of capital income taxation (reflecting the impact on marginal investment decisions of both rates and bases of taxation) regardless the jurisdiction in which they invest. If CEN holds, production is efficient, i.e. output could not be increased by reallocating firms' investments across countries. In other words, intercountry differences in the corporate and personal tax burdens would not affect the locational choice of investment (unless, if claims on domestic and foreign capital are not perfect substitutes, thus affecting the international pattern of investment). However, the existence of tax heaven countries that do not have interest in sharing information with the countries from which they attract capital, and of banking secrecy laws in many countries, makes countries unwilling to abide by this principle, thus imposing taxes at source.

[14] Tanzi Vito (1995), pp. 83-84.

By the same token, uniform application of the source principle ensures the *Capital Import Neutrality* (*CIN*). This efficient condition requires that investment in particular jurisdiction face the same effective marginal tax rate whatever the residence of the investor. If CIN holds, the allocation of savings across consumers will be efficient in the sense that all savers, whatever their jurisdiction of residence, will receive the same after-tax return, that is, they will all face the same prices for future in terms of present consumption. That is, intercountry differences in effective source tax rates would distort the location of investment but would not induce differences in the saving propensity of individuals residing in different countries.

The identification of the efficiency criteria with the international taxation principles hold under the assumptions that capital income taxes are not forward or backward shifted, easily evaded and considered benefit charges (i.e. the tax burden is not offset by proportional benefits in the form of better infrastructure, legal structure, etc). In the case of forward profit tax shifting (to product prices), neutrality is achieved under the source principle (i.e. with the application of the tax exemption method by the residence countries) and border tax adjustments on tradable goods. On the other hand, enforcement of both principles at the corporate level is more effective than enforcement at the personal level. The personal portfolio (debt and equity) investment income is vulnerable to tax evasion, going to a greater or lesser extent unreported to the tax authorities and thus escaping the global income tax of the residence country. This violates the residence principle, but does not necessarily imply interference with the CEN. In particular, to the extent that the financial capital attracted by tax heaven countries is not invested in them, the world allocation of real investments does not change and the before-tax world rate of return to that capital does not fall. Tax heaven countries are too small real economies to affect the allocation of real investment and thus the return to real investment. On the contrary, when large real economies lower their tax rates, then, the financial capital attracted this way is usually followed by real investment, leading to a potential misallocation of recourses because of tax-induced additional investment and violating the CEN. In any case, efficient and unrestricted exchange of information about taxpayers' international income among the jurisdictions concerned, which is necessary condition for the effective enforcement of the residence and source principles, is not easy to be secured. This is due to the existence of tax heaven countries that do not have the interest to share information with countries from which they attract capital, and of banking secrecy laws on other countries, in addition to the legal, political and technical limitations that exist even among non tax heaven countries.

Given the tax priority of the source country and the application of foreign tax credit by the residence country, the CEN does not necessarily maximize the national welfare of the residence country. If the effective tax burden of the source country is greater than or equal to the residence country' one, the tax revenue is effectively collected by the source country. For enhancing the national welfare of the residence country, the after-foreign tax rate of return should be equal to the before-domestic tax rate of return. This is attained when the residence country applies the deduction rather than the credit method.[15]

[15] Musgrave R. A. and Musgrave P. B. (1976), pp. 720-721; MacDougall G. D. A. (1960); Caves R. (1982).

Equity Criteria

International taxation cannot be considered in terms of allocative efficiency alone, but equity must also be taken into account. Equity among the residents of a country should be handled through international tax coordination, whereas equity among residents of different countries presupposes equalized personal tax structures and benefits. Equity between factor ownership should be considered. In a closed economy the tax imposed on all assets of all sectors is being borne in the long run by the owners of capital. In an open economy the tax is shifted (through the exodus of capital) to less mobile factors, particularly unskilled labor, unless the residence principle is effectively enforced or harmonization of the tax structure is effected to particularly all countries with comparable investment.

On the other hand intercountry equity in the distribution of tax revenue takes into account corporate income taxation, withholding taxes on interest payments and dividends to non-residents, and the degree of integration of personal and corporate tax systems across countries. Given the fact that the source country has the first opportunity to tax, the overall level of taxation and the distribution of tax revenue between the source and residence countries is being effectively determined by the treatment of foreign source capital income of the residence country. In any case, intercountry equity is at stake under the differential tax burdens of capital income among source countries that offer possibilities of tax fraud and evasion on the part of residence through various devices in the corporate and personal level, with far-reaching implications for the level and allocation of tax revenue among countries.

In the case of multinational companies where their profits are being allocated in the countries in which they operate, the problem is significant. The companies have an incentive to reallocating taxable profits to low-tax jurisdiction using transfer-pricing devices (through inflating the costs of internationally intracompany trade of inputs that reduce the taxable profits in high-tax jurisdictions), discretionary allocation of fixed costs (such as those for research, development, and general management) or high charges for the use of brand names and other patents, to high-tax jurisdictions (thus reducing taxable profits therein), and financial arrangements (through 'thin capitalization' in the form of shifting debt burdens and the associated interest deductibility to high –tax jurisdiction, i.e. through loan, instead of equity, finance from low-tax countries, thus showing less profits under an inflated debt-equity ratio to the high–tax jurisdiction). It should be clear that manipulation of transfer prices tend to change more the location of taxable income and to a lesser degree the location of real investment. The *arm's length prices criterion* of tax authorities for establishing acceptable transfer pricing (that is determining the market prices for intracompany inputs) proves ambiguous and not very.[16] The *formula apportionment* of taxable profits (according to the territorial distribution of identifiable factors, such as the value of assets, payroll, or sales across jurisdictions) may acquire more legitimacy than now. These factors may be conceptually easy to

[16] The U.S.A. Treasury presented a report in which it suggested that multinational enterprises operating in the U.S.A. were systematically understating their profits: see Internal Revenue Services (1992).

identify, but their calculation in practice is particularly difficult under differences in currencies, and accounting and legal structures.

On the other hand, tax-induced portfolio investment in tax-low countries violates the intercountry equity if the income derived from this goes unreported to the residence country.

Corollary

If the effective tax burden of the income from capital are equalized across countries and there is no discrimination between domestic and foreign investments, then tax systems can guarantee both capital export and capital import neutrality criteria. Regarding such a case as chimerical, the question posed in this respect is which of those two is more conducive to the collective good.

«From the standpoint of the world welfare maximization, the choice between the two criteria depends on the degrees of intertemporal substitution in consumption and of international substitutability of investment. With relatively low intertemporal substitution in consumption (that is low interest elasticity of savings) and relatively high international capital substitution (that is, high elasticity for investment with respect to differences in after-tax rates of return), violations of CIN should be less costly than violations of CEN».[17] On the other hand, the residence principle may also be considered preferable on equity grounds because it is accommodative of the application of progressive global income tax of individuals, leaving a greater freedom of action to government as to the use of the income tax for redistributional purposes.

4. Evolution of Direct Tax Harmonization in the EU

Tax harmonization is an integral part of completing the single market of the EU, commanding attention also in a far wider context (beyond its physical frontiers), as determined by agreements of the EU with European Free Trade Association (forming the European Economic Area), the Central and East European countries, etc. In the context of the Single European Act (EC Commission (1986a)), tax harmonization involves the removal of tax distortions affecting commodity and factor movements in order to bring about a more efficient allocation of resources within an integrated market. Although interpersonal and intercountry equity is not an explicit EU objective, it is important in shaping government attitudes to various harmonization schemes.

The Need for Tax Convergence The common external tariff policy (supplemented by abolition of inter-Member-State tariffs) and (to a satisfactory extent) uniform application of (the type and base of) commodity taxes (excise taxes and VAT) were achieved in EU under the explicit mandate of the Treaty of Rome. This may not have been too difficult especially in the case of commodity taxation which operating under the destination principle do not affect the territoriality of the Member States.

[17] Gardner Edward (July, 1992), pp. 53-54; Giovannini, Alberto (October 1989), pp. 346-386.

However, the need for further harmonization of the tax systems of EU member-states comes implicitly as intimately connected with the removal of border controls and restrictions mandated by the Single European Act of 1987, the establishment of the EMU and the adoption of a single currency (which altogether are very important steps towards the completion of the single market in the EU). The lack of explicit mandate in this respect, together with the fact that the harmonization of direct tax systems in the Member States entails the abolition of national sovereignty, were the main impediments to the progress so far.[18] Tax harmonization seems least urgent as regards relatively immobile (especially unskilled) labor services and certain real assets (i.e. land). On the contrary, the convergence of the complex and particularly differentiated capital income taxation systems of the Member States is the most unsettling area of taxation under the effects of deepening economic integration. Differential effective rates of corporate and financial investment income taxation among countries exert far-reaching distortions in the allocation of capital, saving, risk and financial intermediation, and in the overall level of savings and investment. Equity, both at the interpersonal and intercountry level, is also being affected.

Corporate tax systems of EU Member States, being primarily on a source taxation basis (consistent with the benefit approach), present considerable differences in the degree of their integration with the personal taxation, however, with an apparent ongoing convergence of their tax rates. These systems are differentiated among the classical system (Austria, Belgium, Denmark, Luxembourg, Netherlands, and Sweden), the partial imputation system (France, Germany, Ireland, Italy, Portugal, Spain and UK), the full imputation system (Finland) and a dividend exempt system (Greece).[19] With respect to double taxation alleviation of foreign direct investment income almost all residence Member States provide, as a general rule, for the credit method, and exceptionally the exemption or deduction methods.

The taxation of the cross-border financial investment income (which originates from interest on deposits or bond holdings, dividends and other financial investments) is subjected to the generally applied in the Member-States residence principle under double taxation relief provisions for any foreign source taxation (in the form of withholding taxes on dividends and interest receipts).

The absence of withholding taxes to nonresident taxpayers and the inadequacy for foreign source income reporting enforcement enhance the scope for tax evasion. On the other hand, there is the risk that many foreign taxpayers will avoid to keep or get their savings registered in any source country which introduces an effective exchange of information, even if they pay or are prepared to pay a reasonable withholding tax on the return (thus pushing savings away of such countries or even away of the EU to overseas tax havens). Under these considerations, the liberalization of capital flows in the EU, effected in the 90s (with the removal, among other things, of administrative controls) led the Member-States to a variety of adjustments with respect to the form of enforcement at source-withholding and

[18] Suffice to say that the sovereignty issue is mainly the snag of advancing the commodity tax harmonization on the origin principle, which is more consistent with the completion of the single market.

[19] EU corporation tax systems in 1998/1999; see Simon James and Nobes Christopher (1992), pp.294.

administrative practices concerning the non-residents saving income, at rates and at least on the willingness to exchange information determined from the underlined treaties or unilaterally. The income reporting requirements and the degree of exchange information vary across Member-States, from complete taxpayer anonymity (Luxembourg and Germany) to strict declaration rules and some form of inter member assistance (Spain, Denmark and France). Source-withholding taxes on dividends are levied across Member-States, following the tax treatment of corporations from a conceptual (as benefit charges) and structural (discrimination between corporate and personal level) standpoint, whereas source interest incomes and royalty payments withholding taxes are variably imposed with various degrees of coverage. However, the treatment of these incomes by the authorities of the countries in which they originate also varies, whereby some countries subject them to global income taxes, whereas others give them the particular treatment associated with schedular income taxes.

EU Convergence Approaches

In sum, effective tax rate differentials of capital income across the Member-Stares give rise to tax induced distortions in the cross border capital flows. These distortions are at large one of the main obstacles EU faces towards the deepening of the integrated market. Tax neutrality under a capital income tax harmonization across the Member-States is the necessary condition for efficient allocation of resources within the EU (assuming no other policy-induced distortions, market imperfections, or externalities). The decision to invest or save at home or abroad should depend on before-tax rates of return-assuming uniform public service benefits at home and abroad. In the narrowly defined context of the Single European Act, *tax harmonization* implies convergence of the main determinants of effective tax rates: statutory rates, tax base and enforcement practices. Efforts for such a convergence, ensuring CEN and CIN as mentioned earlier, gained momentum under the liberalization of capital flows in mid-1990. This, being practically (and thus politically) unattainable, led the Commission to the examination and efforts of other more feasible approaches to that effect.

Tax coordination, as an alternative approach, aim to neutralize the effects of tax rate differentials on cross-border capital flows under multiraterally agreed tax adjustments, giving consequences close to those of effective tax rate equalization. This can be effected by the consistent application of the residence principle on a uniform corporation income base and under the effective enforcement of the tax credit method (for double taxation relief) across the Member-States. Coordination of the cross border direct investment taxation derives from the pressures of tax evasion that result from full capital mobility, with differential tax burdens at source, and tax controls that remain constrained by national boundaries. However, there is no consensus as regards the principle (and consequently the neutrality objective) that should govern capital income taxation. The lack of consensus is mainly due to the fact that the interests between net importers and exporters of capital do not coincide as they attempt to balance tax revenue needs and incentive effects. As a result, tax coordination seems uncertain in succeeding the necessary cooperation between Member-States for the satisfactory offset of tax rate differentials in the absence of border controls, giving the risk for new distortions. Hence, the harmonization of the tax structures would seem more necessary than ever. More generally, compared with tax coordination, tax harmonization should enhance welfare because convergence of income tax rates tends to equalize marginal rates of substitution between consumption and saving across countries (since it satisfies the CIN criterion as well).

Under *tax competition*, effective tax rates (net of benefits) tend to converge to the lowest common denominator. The outcome of such competition will depend on the revenue needs of the countries concerned. The countries will compete in their individual capacities trying to their detriment or advantage to adjust accordingly. A country with a relatively small public sector, or a large tax base, or operating as an international financial center, etc, is in a relatively advantageous position to lower effective rates of taxation (net of benefits) and to be more ready for a concerted tax harmonization. However, the natural approximation of taxes may be too slow leaving the EU exposed to distortions inherent to the existing systems.

Corollary

The EU has not been very successful in pushing forward the process of income tax convergence in its member countries: tax harmonization satisfies both efficient criteria but proves politically unattainable; tax coordination, satisfying only one or the other of the two efficient criteria, is restrained by the contradicting interests of the Member-States between these criteria; tax competition is a slow process of uncertain evolution, which, however, have so far succeeded some tax rate convergence. As a result, a non-binding Code of Conduct for Business Taxation, as a coordinated action at European level to reduce continuing distortions in the single market, came into effect on 1 January 1998. [20]

[20] The 1975 'Proposed Directive for the Harmonization of Systems of Company Taxation and of Withholding Taxes on Dividends' recommended the most comprehensive corporate tax structure harmonization: providing the imputation system at a common single statutory rate of tax and imputation credit between 45% and 55%; applying the source principle with respect to the imputations system applied to dividends crossing the borders, with the budgetary cost of the tax credit borne by the host country; imposing 25% withholding tax on dividends to non-corporate shareholders; and extending tax credit to all EEC residents. The directive never adopted because the European Parliament (Official Journal, 1979) announced the prior need to harmonize the computation of the corporate income tax base. However, in 1990, the Commission abandoned its plans for general harmonization in order to concentrate on those details that particularly affect cross-border activity. These moves include: the adoption of the Parent-Subsidiary Directive (Council 1990a), which is designed to reduce the taxation paid between companies resident in Member-States, where there is a holding of at least 25%; and the Merger Directive (Council 1990b) which allows the deferral of capital gains on certain cross-border reorganizations. In 1992, the Ruding Committee reported to the EU (Commission, 1992) the reduction of the corporate tax rate band level and the harmonization of tax bases. The recommendations of the Ruding Report have not been adopted, although corporate tax rates have generally fallen through nationally imposed legislation to the levels recommended. In May 1998 the European Commission presented a proposal for a Council Directive to ensure a minimum of effective taxation of savings income in the form of interest payments within the Community (COM(1998)295). The Commission proposes coexistence model of exchange of information and withholding tax. The Member-States

5. Restructuring Greek Capital Income Taxation in The International Setting

The progressive income tax system, applied historically in the industrialized countries up to date, has never been consistent with the fundamental principles of the comprehensive ideal, either because is impracticable, or undesirable. The discrepancies from the norm in practice, reflecting to a lesser or greater effects the main deficiencies of the nature of the system itself, give rise to various distorting effects in the domestic and international environment. One of the main causes of these distortions stem from the manifold deviations of the (after tax) rate of return to the savers from the (before tax) rate of return on investment, and the differentiation of the former according to the status of the savers-investors and the nature of the assets invested.

The Indigenous Deficiencies of the Greek Income Taxation

The problem is particularly indigenous to Greece. The criticism mainly focuses on the following: First, the conceptual inconsistencies of the system, where important categories of personal savings (i.e. pension contributions) escape taxation, primarily for social reasons, and capital allowances and other deductions are variably recognized under the company taxation, for reasons of promoting investments. Second, the structural inconsistencies of the system, where the various categories of capital income, (i.e. undistributed and distributed companies' profits, interest, capital gains, etc), are independently taxed, for the purpose of affecting saving-investment in directions different from those entailed by subjecting these income categories altogether to the progressive scale of personal taxation, (like earnings). Third, the practical (and in most of cases insurmountable) difficulties in computing deprecations, capital gains/losses and inflationary adjustments. Fourth, the fact that the above inconsistencies and practical difficulties create deep breach in the concept of tax equity. This is clear in the case of four persons of equal annual income from different sources and in particular from: earnings, subjected to the personal progressive scale of taxation (ranging from 5% to 42,5%); dividends burdened with 35% on the company level without any additional personal tax liability; and deposit interests and annual government bonds yield proportionally burdened with 15% and 10% respectively in the form of withholding taxes exhausting this way any personal tax liability. Finally, the administrative complexities, in addition to aforementioned computational difficulties, as a result of the plethora of independent capital income taxes with their consequential complicated procedures of tax verification and collection.

Current Taxation on Cross Border Capital Income in Greece

On the other hand, the Greek border flows of income are subject to the tax structure of the country mentioned in the previous paragraph, adapted under the

have the choice between two systems: a) to enforce that information on interest payments on mainly bank savings going to residents of other Member-States is forwarded to the tax authorities of the home country of the beneficiary of the payment.; and b) introduce a withholding tax of 20% of such interest payments. The withholding tax will be creditable against the tax on the interest in the home country.

worldwide application of the residence and source principles and the tax credit method accordingly.[21] In particular according to the domestic legislation, Greek resident individuals, corporations and personal businesses owe taxes to the Greek government on all of their worldwide income. The tax credit method is provided for foreign source income up to the amount of the corresponding domestic tax liability. Non-resident individuals are subject to the Greek income tax for any Greek source income. Also, the worldwide and the Greek source income of Greek resident corporations and foreign resident corporations respectively are subject to the Greek tax legislation. However, the Greek (as any other national) tax legislation of cross border income flows, reflect domestic and consequently unilateral tax arrangements, subject to the risk for excessive claims against the foreign residents. As a result, Greece has singed bilateral treaties with various countries, for ensuring limitation of the tax claims of the source country and avoiding double taxation in the residence country. Tables B and C show the tax rates and the double taxation relief methods of a number of Greek bilateral treaties for interest income, dividends and branches' income or profits. The tax rates contained in the bilateral treaties are the maximum rates applied by the source country. If the source country legislation provides for lower or zero tax rates, it is these rates that should be applied. Branches and subsidiaries of foreign corporations are taxed according to the source country legislation for home companies without any discrimination, while the ambiguous arm's length prices criterion is provided for multinational companies. The income of home corporations and branches of foreign corporations is subject to 35% and 37,5% rates according to whether the corporations are introduced or not to the Stock Exchange of their residence countries respectively; whereas the income of Greek companies of Ltd liability and partnerships (net of the 'entrepreneur charge' of the manager partner-associate, which is subjected to the personal progressive scale of taxation) is taxed with 35% and 25% respectively. Due to the special regime of corporate tax applied in Greece after Law 2065/1992, according to which the corporate profits are taxed on the name of the corporation, without any additional personal taxation on dividends, the tax rate for dividends provided for by the treaties do not have any importance (see Table C, column of dividends).

Different Philosophies

Greece has being engaged in the income tax competition environment prevailing in the EU, owing to the liberalization of capital flows under a lack of any successful harmonization or coordination in this field. In this respect, Greece faces three main constraints: the relative high tax ratios of the country; its revenue needs (as determined by its social welfare function, recourse endowment and public sector debt); and the fact that the deficiencies of current capital income taxation is (not an exclusive trait of the country but) an inescapable product of the internationally adopted choice of the CIT approach. Following necessarily the effective tax rate reduction policy of its competitors, Greece may minimize the costs but is very

[21] Art. 3 L.3323/55, as modified by art.2.1 of L.2238/98; Art. 4 L.3843/58, as modified by art. 99 of L.2238/98; Ministry of Finance: M 4500/1961, A 5178/1966.

difficult to gain any competitive advantage especially against its more efficient competitors. Adherence to the CIT version of capital income taxation preserves the aforementioned deficiencies of the system in relative terms, although at a lower distorting level (depending on the succeeded tax rate convergence). In any case, under the most optimistic estimates other things being equal, the competitive position of Greece is expected to remain relatively the same under these circumstances. The alternative in this respect would be a radical reform in the direction towards the CFIT. Such a reform will ensure Greece the necessary tax competitive impetus against its competitors, respecting the first two constraints and canceling the third one. The tax treatment of the domestic and the cross border income and profits of Greece will be relieved of the current deficiencies, and the economy will be attractive of funds on a tax induced basis.

The International Cash-Flow Tax implications

A shift by Greece from income to cash flow taxation would have major implications for international transactions. Although the definition of residence is difficult, the residence principle, if accepted internationally, would seem an appropriate basis for assessing a Cash Flow Tax (CFT) on personal and corporate level, that is a progressive personal CFIT coupled with a proportional Cash Flow Corporation Tax (CFCT), respectively. Under the CFIT, «receipts of residents will be included in the tax base, regardless of source; investments or savings of residents, whether at home or abroad would be deductible; and consumption of residents, would be taxed regardless of where it occurs».[22] The need for foreign tax credit would be eliminated, and the progressive scale structure would be applied only once to all consumption. In particular, given the fact that the remittance of CFIT (which is recognized by definition) when the funds are saved and invested is tantamount to remitting the tax on the subsequent yield on such funds (according to the equivalence between cash-flow and the pre-paid treatment of assets mentioned earlier), then granting also double taxation relief (credit) on the yield on foreign investment, it is in effect giving a tax subsidy on foreign investment. Suppose that a 10% tax rate and a 50% underline rate of yield of real capital apply the same in a CFT and an Income Tax (IT) country. In both counties the market rate of interest will be linked to this 10% yield.[23] Under these circumstances, IT country residents, will get a post-tax rate of return of 5% on their savings whether they invest them at home or in the CFT country, since in the latter case the foreign tax credit offset the home tax liability). On the other hand, CFT country residents, will enjoy the pre-tax rate of return of 10% on their savings if they invest them at home, and of 10% or 5% if they invest them in the IT country, according to whether they do or do not enjoy in the CFIT country double taxation relief from income tax on their foreign investment income. Thus, the refusal of the CFT country of one or other of the two tax reliefs (on overseas investment or double tax relief on the yield on overseas investment) will operate as disincentive for the CFIT country's savings to be invested abroad,

[22] Graetz Michael (1980), p.249.

[23] For a deeper analysis on this, see Hines James (1996), pp.473-480.

a disincentive «which springs, not from any tax discrimination by the ET country, but from the simple fact that the ET [CFIT] has devised a tax regime to stimulate savings-investment, while the IT country has not chosen to do so».[24] Furthermore, granting double tax relief on foreign income, that is giving credit of foreign source income tax against domestic expenditure tax, is not consistent from a conceptual and structural standpoint.

On the other hand, the CFCT of section 2 (confined to corporations), like the CFIT (confined to individuals) does not break the link between the market interest rate and the pre-tax rate of yield on company' real assets; and in addition, raises the same issues as to whether it is desirable to grand both tax reliefs on the foreign investment and also on the subsequent income from that investment.

As to the first, it should be noted, that the provision for 100% capital allowances (i.e. the deduction of capital assets acquisition) has the effect to equalize the pre-tax rate of return on real assets with the post-tax interest rate. As is shown in table A (column 4), given the above IT country and CFT country (with the same tax rate and initial yield on investment, say 50% and 10% respectively), an IT country resident investor in real assets will get a post-tax rate of return of 5% investing at home, and 10% investing in the CFT country. With 100% capital allowances in the CFT country, the investor will be able to finance a capital asset of a total value (1.500DRC) which would be in excess of his independent investment (750DRC) by the remission of 50% corporation tax on that value (50%X1.500). As a result, he gets a pre-tax return (10%X1.500=150) which: as percentage of his independent investment (150/750=20%) corresponds to a market interest rate; and as percentage of his total investment (150/1500=10%) is higher than the previous one, standing for the rate of return on the underlying investment in real assets. Under these circumstances, it is the post-tax rate of interest which will be linked to the rate of return on the underlying investment in real assets. «This means that, with an initial real yield of 10% in both countries, the market rate of interest would tend to be 20% in the CFT country and only 10% in the IT country. With double taxation relief on foreign investment income in the IT country, capital funds would be attracted from the IT country to the CFT country for investment in the CFT country. If the international capital market and both national capital markets were perfect, this attraction of capital funds would go on until physical investment in the CFT country was so expanded that the underlying rate of yield on investment in real asseta had fallen to 5%. The post-tax rate of interest in the CFT country would tend to be 5%, and the pre-tax market rate of interest would tend to be 10%».[25]

As to the second one, the granting of both reliefs on foreign investments by the CFCT country is not justified for the same reasons mentioned in the case of CFIT above.

Be that as it may, a second levy on businesses in the form of withholding tax on dividends, interest, rents, and royalties they pay to foreign investors and corporations

[24] Meade J. E. (1978), p.414-415.

[25] Meade J. E.(1978), p.232, 418.

(in respond to the current withholding taxes on payments abroad which could be credited against other taxes due in the foreign country), should be provided for in a way that would not cancel the competitive advantage Greece would enjoy under the CFT. The same should apply to Greek branches of foreign corporations, which maintain consolidated accounts for calculating the income tax, as a proxy for the withholding tax on cash distributions to foreigners by Greek corporations.

Emigration and Immigration under Cash-Flow Income Taxation

Under a CFIT there would be incentive for people to leave a CFT country when they intend to dissave by living on previously accumulated capital, thus avoiding the CFIT and IT altogether. A special tax on the entire value of an emigrant's assets would be the case. The tax avoidance problem in this respect may not be that important. Under an IT country, a person need only move capital to a tax heaven country to avoid tax; under an CFIT country he himself would have to move. However, any such tendency of CFIT citizens and residents to emigrate should be offset by the countervailing tendency of people to immigrate to the CFIT to avoid income taxes abroad.

Corollary The application of CFT in Greece will enhance the relation between the after-tax rate of return to the resident and foreign savers and the before-tax domestic yield on investments, thus giving incentives for residents and foreigners to invest domestically. The practical barrier to a CFT system based upon the residence principle is that international harmonization would come slowly, if at all. Some industrialized countries would probably retain income taxes, and taxing income based upon its source (rather than its owner's residence) would remain attractive to countries that are net importers of capital.

6. Conclusions

The liberalization of capital flows and the introduction of Euro within the frame of the EMU, expose Member-States to an ongoing process of capital income tax competition as any harmonization attempts in this field of taxation have failed so far. Such a tax competition, calling for a reduction of effective tax rates to a common denominator in the EU, is quite painful for countries of high taxation and public debt, like Greece. Furthermore, this competition, carried on within the existing structures of the Member-States income tax, necessarily maintain the deficiencies of the predominant nature of this structures and the effects of expenditure tax elements which are variably incorporated therein (like the exemption of retirement contribution, capital allowances, etc), although at a lower level. One of the main deficiencies of the former is the non-neutrality of income tax between present and future consumption, setting the (post-tax) rate of return to the saver at a lower level than the (pre-tax) rate of return on investment. In contrast, the expenditure tax treatment of specific categories of saving and investments ensures the equality between the above rates of returns as a consequence of the main trait of this tax concerning its neutrality between consumption and saving.

In this frame, Greece has the option of either following the competitive approach of the other Member-States within the given income tax structure or carrying forward a radical restructuring of its system towards the expenditure tax on the basis of cash-flow income tax. The second option gives the country the opportunity to avoid the potential trap of revenue degradation entailed by the first option. Instead of being drawn behind the tax rate reduction initiatives of the most flourishing competitors within the current structure of income tax, it will enhance its relative competitive position by shifting the taxation from income to consumption. Such a shift, effected on the basis of equal revenue yield, will prove more efficient in the domestic production, whereas it is expected to discourage exporting of capital and attract foreign direct investment.

Be that as it may, the impact on international arrangements and capital flows of a shift by Greece from income to expenditure taxation needs special probing. This paper mentions the relative merits of such a policy purporting to constitute a starting point for a thorough consideration in this respect. Some issues have only been touched on here, while still others have been set aside altogether.

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Table A: *The four Versions of Income Taxation*[*]

	INCOME TAX (IT) (1)		**CASH FLOW INCOME TAX (CFIT) (2)**		**PRE-PAID METHOD OF CFIT (3)**		**INCOME TAX WITH 100% CAPITAL AL-LOWANCES (4)**	
Forgone Consumption	$X(1-t)$	750	$X(1-t)$	750	$X(1-t)$	750	$X(1-t)$	750
Earnings	X	1500	X	1500	X	1500	X	1500
Tax	Xt	750	–	–	Xt	750	Xt	750
Savings	$X(1-t)$	750	X	1500	$X(1-t)$	750	$X(1-t)$	750
Rate of Return on Investment	r	**10%**	r	**10%**	r	**10%**	r	**10%**
Investments	$X(1-t)$	750	X	1500	$X(1-t)$	750	X	1500
Yield	$X(1-t)r$	75	Xr	150	$X(1-t)r$	75	Xr	150
Tax	$X(1-t)rt$	37,5	Xrt	75	–	–	Xrt	75
Net of Tax Yield	$X(1-t)^2r$	37,5	$X(1-t)r$	75	$X(1-t)r$	75	$X(1-t)r$	75
Net Yield as % of Forgone Consumption	$r(1-t)$	**5%**	r	**10%**	r	**10%**	r	**10%**

**The structure of the table is based on the concepts of income as defined for tax purposes in section 2 of the present paper. It is assumed that X (=1500), t (=50%) and r (=10%) stand for earnings, tax rate and rate of return respectively.*

Table B: *Foreign Source Tax Rates of Greek Capital Income Recipients and Double Tax Relief Methods of Residence (Greece) Country under Respective Double Taxation Treaties*

Source Country (of Capital Income Received by Greek Resident)	INTEREST INCOME		DIVIDENDS		PROFITS OF GREEK BRANCHES ABROAD	
	Tax Rate of Source Country %	Double Taxation Relief Method of Resident Country (Greece)	Tax Rate of Source Country %	Double Taxation Relief Method of Resident Country (Greece)	Tax Rate of Source Country %	Double Taxation Relief Method of Resident Country (Greece)
Austria	0 or 10 [1]	Tax Credit	Internal Law [2]	Tax Credit	Internal Law	Tax Exemption
Belgium	10	Tax Credit	15	Tax Credit	Internal Law	Tax Credit
Cyprus	10	Tax Credit	25	Tax Credit	Internal Law	Tax Credit
Denmark	8	Tax Credit	18	Tax Credit	Internal Law	Tax Credit
Finland	10	Tax Credit	13	Tax Credit	Internal Law	Tax Credit
France	12	Tax Credit	Internal Law [2]	Tax Credit	Internal Law	Tax Credit
Germany	10	Tax Credit	25	Tax Credit	Internal Law	Tax Credit
Italy	10	Tax Credit	15	Tax Credit	Internal Law	Tax Credit
Luxembourg	8	Tax Credit	7.5	Tax Credit	Internal Law	Tax Credit
Netherlands	8 or 10 [3]	Tax Credit	5 or 15 [4]	Tax Credit	Internal Law	Tax Credit
Norway	10	Tax Credit	20	Tax Credit	Internal Law	Tax Credit
Sweden	10	Tax Credit	0 [5]	Tax Credit	Internal Law	Tax Credit
Switzerland	10	Tax Credit	5 ή 15 [6]	Tax Credit	Internal Law	Tax Credit
U.K.	0	Tax Credit	Internal Law [7]	Tax Credit	Internal Law	Tax Credit
U.S.A.	0 [8]	Tax Credit	Internal Law [9]	Tax Credit	Internal Law	Tax Credit

Source: *Bilateral treaties of Greece with the respective countries.*

Comments:

(1) The 10% rate applies to Greek recipients of interest, who participate with more than 50% in the equity capital of the Austrian debtor company. On the contrary, interest income from Austrian Government securities is taxed in Austria.

(2) Dividends paid by Austrian or French resident company to Greek recipients, are taxed in both (source and residence) countries according to their respective internal legislation. Double taxation relief is succeeded under the tax credit method.

(3) The 8% rate applies to bank as recipients.

(4) The 5% withholding tax applies to Greek recipients of dividends (paid by companies resident in Netherlands) who are corporate or Ltd companies controlling at least 25% of the equity capital of the former; whereas in the rest cases the withholding tax rate is 15%.

(5) The application of this rate follows the specifications contained in the respective bilateral treaty.

(6) The 5% withholding tax applies to Greek recipients of dividends paid by companies resident in Switzerland participating by at least 25% in the equity capital of the former; whereas in the rest cases the withholding tax rate is 15%.

(7) The internal dividend tax law of the respective contractual countries applies; double tax relief is provided for under the tax credit method accordingly.

(8) Interests paid by USA legal person to Greek recipients (natural or legal persons), without permanent establishment in USA, are not subjected to USA taxation, unless the Geek recipient is a company controlling, directly or indirectly, more than 50% of the votes of the former.

(9) The USA internal dividend tax legislation applies; double tax relief is provided for under the tax credit method accordingly.

Table C: *Greek Source Tax Rates for Foreign Capital Income Recipients and Double Tax Relief Methods of Residence Countries under Respective Double Taxation Treaties*

Resident Country (of Capital Income Recipient)	INTEREST INCOME		DIVIDENDS [1]		PROFITS OF FOREIGN BRANCHES IN GREECE	
	Tax Rate of Source Country (Greece) %	Double Taxation Relief Method of Resident Country	Tax Rate of Source Country (Greece) %	Double Taxation Relief Method of Resident Country	Tax Rate of Source Country (Greece) %	Double Taxation Relief Method of Resident Country
Austria	0 or 10 [2]	Tax Credit	Internal Law [3]	Tax Credit	Internal Law	Tax Exemption
Belgium	15	Tax Credit	25	Tax Credit / Tax Exemption [4]	Internal Law	Tax Exemption
Cyprus	10	Tax Credit	25	Tax Credit	Internal Law	Tax Credit
Denmark	8	Tax Credit	38	Tax Credit	Internal Law	Tax Credit
Finland	10	Tax Credit	47	Tax Credit / Tax Exemption [4]	Internal Law	Tax Credit
France	10	Tax Credit [5]	Internal Law [3]	Tax Credit [5]	Internal Law	Tax Exemption
Germany	10	Tax Credit [5]	25	Tax Credit [5]	Internal Law	Tax Exemption
Italy	10	Tax Credit	15	Tax Credit	Internal Law	Tax Credit
Luxembourg	8	Tax Credit [5]	38	Tax Credit / Tax Exemption [6]	Internal Law	Tax Exemption
Netherlands	8 or 10 [7]	Tax Credit [5]	35	Tax Credit [5]	Internal Law	Tax Exemption

Norway	10	Tax Credit	40	Tax Credit	Internal Law	Tax Exemption
Sweden	10	Tax Exemption [13]	0[12]	Tax Exemption [13]	Internal Law	Tax Exemption
Switzerland	10	[8]	35	[8]	Internal Law	Tax Exemption
U.K.	0	Tax Credit	Internal Law [9]	Tax Credit	Internal Law	Tax Credit
U.S.A.	0 [10]	Tax Credit	Internal Law [11]	Tax Credit	Internal Law	Tax Credit

***Source:** Bilateral treaties of Greece with the respective countries.*

Comments:

(1) The bilateral agreement provisions about the dividends taxation may not have practical significance, because after 1992 the total (distributed or not) corporate profits is taxed on the corporate level without any additional taxation of dividends on the personal level of the recipients.

(2) The 10% rate applies to Austrian recipients of interest, who participate with more than 50% in the equity capital of the Greek debtor company. On the contrary, interest income from Greek Government securities is taxed exclusively in Greece.

(3) Dividends paid by Greek resident company to Austrian, or French recipients, are taxed in both (source and residence) countries according to their internal legislation. Double taxation relief is succeeded under the tax credit method.

(4) Special exemption is provided in the case the dividends recipient is a company.

(5) Deduction of some portion of the tax is provided in specific circumstances.

(6) Deduction of some portion of the tax is provided in specific circumstances; whereas in other circumstances the tax exemption method is provided in cases where the Luxembourg companies participate in the equity capital of Greek companies by more than 25%.

(7) The 8% rate applies to bank recipients.

(8) The double taxation relief may be provided by the alternative methods of credit, deduction or partial exemption.

(9) The internal dividend tax law of the respective contractual countries applies; double tax relief is provided for under the tax credit method accordingly.

(10) Greek source interests paid to USA recipients, who do not have permanent establishment in Greece, are exempted from the Greek tax if the interest rate does not exceed the level of 9% annually. This exemption does not apply to the USA company which owns more than 50% of the equity capital of the Greek debtor company.

(11) The Greek dividend tax law applies; double tax relief is provided for under the tax credit method accordingly.

(12) The application of this rate follows the specifications contained in the respective bilateral treaty.

(13) Under special provisions.