

The Notion of Income from Capital

EATLP Congress, Cologne 12-14 June 2003

Editors:

Peter Essers and Arie Rijkers

General reporters: Prof. Peter Essers and Prof. Arie Rijkers, Tilburg University,
The Netherlands

Contributors: Prof. Henk van Arendonk, University of Rotterdam,
The Netherlands
Prof. Laura Castaldi, University of Siena, Italy
Prof. Judith Freedman, University of Oxford, United Kingdom
Prof. Wolfgang Gassner (University of Business
Administration Vienna, Austria)
Prof. Daniel Gutmann, University Paris-1 Panth6on-Sorbonne,
France
Dr. Kevin Holmes, University of Budapest, Hungary
Prof. Peter Kavelaars, University of Rotterdam,
The Netherlands
Prof. Joachim Lang, University of Cologne, Germany
Prof. Leif Muten, Stockholm School of Economics, Sweden
Prof. Manfred Rose, University of Heidelberg, Germany
Dr. Ian Roxan, London School of Economics, United Kingdom
Prof. Claudio Sacchetto, University of Turin, Italy
Prof. Alain Steichen, University of Luxembourg, Luxembourg
Prof. Bertil Wiman, Stockholm School of Economics, Sweden



Volume 1
EATLP International Tax Series

TABLE OF CONTENTS

Preface	xix
About the authors	xxi
Introduction	xxiii

Peter Essers and Arie Rijkers

PART A GENERAL ASPECTS OF AN INCOME TAXATION ON INCOME FROM CAPITAL

Chapter I: The influence of tax principles on the taxation of income from capital	3
--	----------

Joachim Lang

1. Introduction	3
2. The framework of tax principles in the constitutional and the European law	4
2.1. Tax equity and equality	4
2.2. Certainty	4
2.3. Right to property	5
2.4. Rights of the family	7
2.5. The four freedoms of the EC Treaty	7
3. Specific tax principles to determine the income	8
3.1. Ability to pay	8
3.2. Individual taxation	13
3.3. Real income versus inflationary gains and fictitious income	14
3.4. Net income	15
3.5. Non-disposal income	16
3.6. Efficiency of taxation: fiscal neutrality and simplicity	17
3.7. Periodicity	17

Table of contents

4.	Theories and methods to determine the income	18
4.1.	The historical debate: net accretion theory versus source theory	18
4.2.	The present debate: accrual method versus cash flow method	21
5.	Notion of income towards a cash flow income tax?	24
5.1.	The phenomenon of a hybrid income taxation	24
5.2.	Schedular or global income taxation?	26
5.3.	Two essentials of the income from capital	28
5.3.1.	Taxation of pension schemes	28
5.3.2.	Treatment of capital gains and losses	29
6.	Conclusions	30

Chapter I A: The influence of tax principles on the taxation of income from capital-a response

33

Wolfgang Gassner

1.	Introduction	33
2.	Economic theory and the notion of income	34
2.1.	Notion of income as a multidisciplinary issue	34
2.2.	Economic theory and legal definition of income	34
3.	Foundation concept of income and tax legislation	36
3.1.	Schanz-Haig-Simons model as "superior to other models"	36
3.2.	Global income tax as a "matter of fairness"	36
3.3.	Creation of "generally accepted income definition" by scholars	38
3.4.	Income tax base with a "non political character"	39
4.	Tax principles and their influence on the notion of income	40
4.1.	The high esteem for the ability-to-pay principle	40
4.2.	The "features" of the ability-to-pay principle	42
4.2.1.	"Lifetime notion of income"	42
4.2.2.	"Real and realistic income"	42

Table of contents

4.2.3. "Global income"	43
4.2.4. "Representing new power"	43
4.3. "Guidance given" by the ability-to-pay principle	43
4.4. The context of the ability-to-pay principle	44
4.5. The tree of principles in tax methodology	45
5. The notion of income from capital	46
5.1. "Income tax base blight" to be reduced to the market income"	47
5.2. "Lifetime income is the right Measure of ability to pay"	47
5.3. "Basically fictitious of deemed income should not be part of the income tax"	47
5.4. "The net principle demands the full deduction of costs and losses"	48
5.5. "The concept of the lifetime ability to pay demands a cash flow notion of income"	49
5.6. "In the long run the notion of income should move towards a cash flow income tax"	49
5.7. "Splitting rules consider the distribution of income among spouses and other family members in accordance with the individual taxation rule"	50
5.8. "Finally the non-disposal income ought to be excluded from the tax base"	50
6. Realism versus Utopism in legal tax theory	51
7. Final remarks	52
Chapter II: Economic aspects of taxation of income from capital	53
<i>Manfred Rose</i>	
1. Factors determining the definition of taxable income from an economic standpoint	53
2. The technical notion of yearly income as a guideline for the notion of taxable income - the traditional approach	58

Table of contents

3.	The economic notion of lifetime income as a guideline for the notion of taxable income	62
3.1.	The citizen's lifetime income from an economic standpoint	62
3.2.	The notion of taxable income corresponding to the notion of lifetime income	63
3.2.1.	The segregation of income elements that have already been burdened and that will be taxed at some time in the future	63
3.2.2.	The segregation of transfer incomes	66
4.	Evaluation of alternative systems of taxing lifetime income	68
4.1.	Decision neutrality	68
4.2.	Administrative efficiency	70
4.3.	Taxation versus tax burdening	70
5.	The simplest method of taxing lifetime income	72
6.	Summary	75
7.	References	76

Chapter III: Relationship between personal income tax on income from capital and other taxes on income from capital (corporate income tax, wealth tax, inheritance and gift tax and real-estate tax)	77
---	-----------

Claudio Sacchetto and Laura Castaldi

1.	The combination of personal income tax and wealth tax	77
1.1.	Does the combination of personal income tax on capital proceeds and a wealth tax cause double taxation?	77
1.2.	The trend of developing fiscal systems in which income taxes and wealth taxes coexist	79
1.3.	The degree of acceptability of a tax system developing a periodical ordinary direct tax on income/capital proceeds and other taxes on capital/Wealth	80

Table of contents

2.	Income taxes; taxing the proceeds of the use of capital in the light of income tax: the principles	83
3.	Taxation of income from capital	86
3.1.	The income tax on the proceeds coming from capital gains and the examples of possible double objective tax	86
3.2.	Should capital gains be considered as capital income (i.e. revenues from the use of capital)?	88
3.3.	Possible cases of double income tax coming from the incorporation of profits/interests in the compensations of share assignments	89
4.	Taxation of dividends, capital gains and profits of participations	90
4.1.	The problem of the tax treatment of the proceeds causally referring to participation in associations, when the latter are already subject to income tax	90
4.2.	The possibility that the tax treatment of the proceeds coming from (and for the effect of) participating relations must be separated according to the lucrative and non-lucrative causal of the connotation of the participation bond	91
4.3.	The possibility that the actual problem of subject double imposition of group incomes refers solely to the incomes coming from participations, in reference to associations in which the participation connotes causally for the pursuit of the single members' lucrative aims	92
4.4.	Possible justifications of double income tax on company revenues	92
4.5.	Solutions to eliminate/decrease double tax on company revenues	94

Table of contents

Chapter IIIA: Relationship between personal income tax on income from capital and other taxes on income from capital (corporate income tax, wealth tax, inheritance and gift tax and real-estate tax) -a response **97**

Daniel Gutmann

Chapter IV: Fixed amount taxation with respect to income from capital in personal income taxation **103**

Henk van Arendonk

1. Introduction	103
2. Theoretical framework	104
3. The practice of fixed amount schemes	106
3.1. Notional rental value for owner-occupiers	106
3.2. Bare ownership/usufruct situations	107
3.3. Income foreign investment companies	108
3.4. Fixed amount return for saving and investing	110
4. Kinds of fixed amount schemes	111
5. Fixed amount schemes and the theoretical framework	114
6. Some important issues	122

PARTB

THE NOTION OF INCOME FROM CAPITAL: THE TAXABLE BASE

Chapter I: Accrual versus realization **127**

Peter Kavelaars

1. Introduction	127
2. (Annual) valuation	128

Table of contents

3. Liquidity: how to pay tax?	130
4. Losses	134
5. Migration	135
6. Treaty aspects	137
7. Inflation	140
8. Some special situations	140
8.1. Death	140
8.2. Gifts	141
8.3. Divorce	141
8.4. Mergers and splits	142
9. Closing considerations	143
Chapter II: Deferral possibilities	147
<i>Kevin Holmes</i>	
1. Introduction	147
2. Meaning of deferral	148
3. Tax policy and deferral	151
4. Deferral mechanisms in selected jurisdictions of the new Europe	157
4.1. Deferral of recognition of dividend income	158
4.2. Deferral of recognition of interest income	159
4.3. Deferral of recognition of rental income	160
4.4. Deferral of recognition of royalty income	163
4.5. Deferral of recognition of capital gain	164
4.6. Participation exemptions	170
4.7. Corporate reconstructions	172
4.8. Change of residential status	173
4.9. Capital losses	174
4.10. Intra-family arrangements	175

Table of contents

5. Anti-avoidance provisions	178
6. Conclusion	179
Chapter IIA:Deferral possibilities - a response	183
<i>Alain Steichen</i>	
1. Concept of deferral of taxation	183
2. Normative assumptions	184
3. Two types of tax deferrals	185
4. Tax deferrals have a cost to the tax revenue	186
5. Are tax deferral provisions unjust?	187
6. Trade off between justice and efficiency	187
7. Conclusions	188
Chapter III: Treatment of capital gains and losses	191
<i>Judith Freedman</i>	
1. Introduction: concepts of capital gains and income	191
2. Approaches to taxation of capital gains and losses	195
2.1. Three models	195
2.2. Distinguishing capital gains from other income gains	196
2.3. Special treatment of capital gains	197
3. Rationale for special treatment of capital gains	198
3.1. Qualitative differences	198
3.2. Ability to pay and equity	200
3.2.1. Realization versus accruals basis	200
3.2.2. Moving away from realization - marking to market and following the commercial accounts	202

Table of contents

3.2.3. Retaining realization but removing the benefit	205
3.2.4. Bunching and inflation	207
3.3. Incentives and reliefs	208
4. Losses	210
5. Conclusion	212
6. References	215
Chapter IIIA: Treatment of capital gains and losses - a response	217
<i>LeifMuten</i>	
Chapter IV: Influence of inflation	223
<i>JanRoxan</i>	
1. Introduction	223
2. Effects of inflation on tax revenues	224
2.1. Fiscal drag	224
2.2. Collection effect	225
3. Effects of inflation on the tax base	225
4. Inflation adjustment mechanisms in use	227
4.1. Partial adjustment	227
4.1.1. Capital gains	227
4.1.1.1. An illustration: the United Kingdom	227
4.1.1.2. Other approaches in Europe	230
4.1.2. Interest	232
4.1.3. Business profits	233
4.2. Global adjustment	234
4.3. Adjustment of tax rate and allowance thresholds	237
5. Desirability of adjusting income from capital for inflation	238
5.1. Equity considerations	238
5.2. Efficiency considerations	239

Table of contents

5.3. Administration costs	239
6. Desirability of particular inflation adjustment methods	240
6.1. Indexation	240
6.2. Indexation for specific assets	240
6.3. Indexation and the realization basis	241
6.4. Business profits	242
6.5. Tax bases that exclude inflationary returns	243
7. Conclusions	244
8. References	24%
Chapter V: Imputed income (including deductible costs)	249

ianMoxan

1. Imputed income	
1.1. Problem of imputed services from assets	249
1.2. Imputed income from housing	250
1.2.1. Prevalence	250
1.2.2. Grounds for taxing imputed rent	250
1.2.3. Measuring the returns on housing: relevance of ex ante and ex post returns	251
1.2.4. Taxation of imputed rent in Europe	253
1.2.5. Taxation of capital gains on private housing	254
1.2.6. Conclusion	254
1.3. Imputed income on other assets	255
2. Deemed income	255
2.1. The use of deemed values - two cases	255
2.2. Deemed values reflecting true values	256
2.2.1. Non-arm's length transfers	256
2.2.2. Deemed transactions	257
2.2.3. Measure of deemed value	258
2.3. Deemed values used to implement policy objectives	259
2.3.1. Deemed values in relieving provisions	259
2.3.2. Restrictive deemed values	259

3. Conclusion	261
4. References	262
 Chapter VI: Emigration taxes	 263
<i>Bertil Wiman</i>	
1. Introduction	263
2. National law	267
3. Tax treaty perspective	268
4. EC law perspective	270
5. Concluding remarks	275

PART C
GENERAL REPORT

Peter Essers and Arie Rijkers

1. Introduction	281
2. General aspects of an income taxation on income from capital	281
2.1. The influence of tax principles on the taxation of income from capital	281
2.1.1. Income tax as a model	281
2.1.2. Concept of income a multidisciplinary issue?	283
2.1.3. Comprehensive income tax	284
2.1.4. The ability-to-pay principle	286
2.1.5. Robbery?	291
2.1.6. Science versus politics	293
2.2. Economic aspects of taxation of income from capital	294
2.2.1. A lifetime notion of income	294
2.2.2. Economic versus legal approach	295

Table of contents

2.3.	Relationship between personal income tax on income from capital and other taxes on income from capital	296
2.3.1.	Combination of wealth tax and personal income tax	296
2.3.2.	Combination of capital gains tax and gift and inheritance taxes	299
2.3.3.	Combination of personal income tax on dividends and capital gains tax on shares and a corporate income tax	300
2.4.	Fixed amount taxation with respect to income from capital in personal income taxation	302
2.4.1.	Between justice and practicability	302
2.4.2.	Solutions	303
2.4.3.	Degressive effective tax rate	304
2.4.4.	Discussion themes	305
	2.4.4.1. Fictitious	305
	2.4.4.2. Unconstitutional?	308
	2.4.4.3. Harmonization and tax policy	309
3.	The notion of income from capital: the taxable base	311
3.1.	Accrual versus realization	311
3.1.1.	Is realization an inherent part of the notion of income (from capital)?	311
3.1.2.	Valuation, liquidity and lock-in	312
3.1.3.	International aspects	315
3.1.4.	Discussion	315
3.2.	Deferral possibilities	317
3.2.1.	The range of deferral	317
3.2.2.	Deferral and tax avoidance	318
3.2.3.	Deferral and tax policy	319
3.2.4.	Lock-in effect	321
3.2.5.	Legal comparison	322
3.3.	Treatment of capital gains and losses	322
3.3.1.	Normal or special income?	322
3.3.2.	Capital losses	324
3.4.	Influence of inflation	625
3.4.1.	Equity, efficiency and costs	325
3.4.2.	Compensation measures and types of return	325
3.4.3.	All or nothing	326
3.4.4.	Feasible systems	326
	3.4.4.1. Global adjustment	326

Table of contents

3.4.4.2. Dutch system of presumptive return	327
3.4.4.3. A fund for deduction	328
3.4.5. Conclusion	329
3.5. Imputed income	329
3.5.1. Owner occupied housing	329
3.5.2. Deemed values and transactions	330
3.5.3. Deemed values for policy and anti-avoidance reasons	331
3.6. Exit taxes	331
3.6.1. Conflict with the ability-to-pay principle?	331
3.6.2. Treaty override?	332
3.6.3. EC aspects	333
4. General conclusions	334