

**Ortmann, Regina, Pummerer, Erich (2023)**

**Distortional effects of separate accounting and formula apportionment on factor allocation**

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Abstract:

We examine distortions caused by tax base allocation systems—separate accounting (SA) or formula apportionment (FA)—with respect to the allocation of assets and workforce within multinational entities (MNEs). The effects of both systems are intensively debated by EU Member States as they are striving to implement a European tax system. Its introduction would lead to a switch from SA to FA. Moreover, Pillar One of the recent global tax reform includes a mix of both tax base allocation systems. We find that, against the claims of the EU, FA does not necessarily create lower distortions of the factor allocation. Decisive for that assessment is the level of profit shifting under SA. Our results indicate that, in tendency, the factor allocation is more severely distorted by FA when the profit shifting possibilities were rather low under SA. In contrast to former studies, we highlight the importance of analyzing the status quo under the recently applied system (SA) in order to be able to assess the consequences of a switch from SA to FA. Our results are interesting for policy-makers as they help anticipating reactions of MNEs to a change in the applied tax base allocation system and for companies as a basis for future tax planning.