Public Policy 290 – Graduate Public Economics

Global Tax Competition

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Roadmap

Globalization raises key challenges for the taxation of corporate profits

1. Tax competition $\rightarrow$ can lead government to adopt sub-optimally low corporate tax rates

2. Profit shifting $\rightarrow$ can lead to large corporate tax revenue loss

Size of the phenomenon? Mechanisms? Policy solutions?

1 Tax competition

Reminder on source vs. residence based corporate taxes:

- Source (= *territorial*) taxation: profits taxed where prod. occurs

- Residence (=*worldwide*) taxation: profits taxed where owner lives

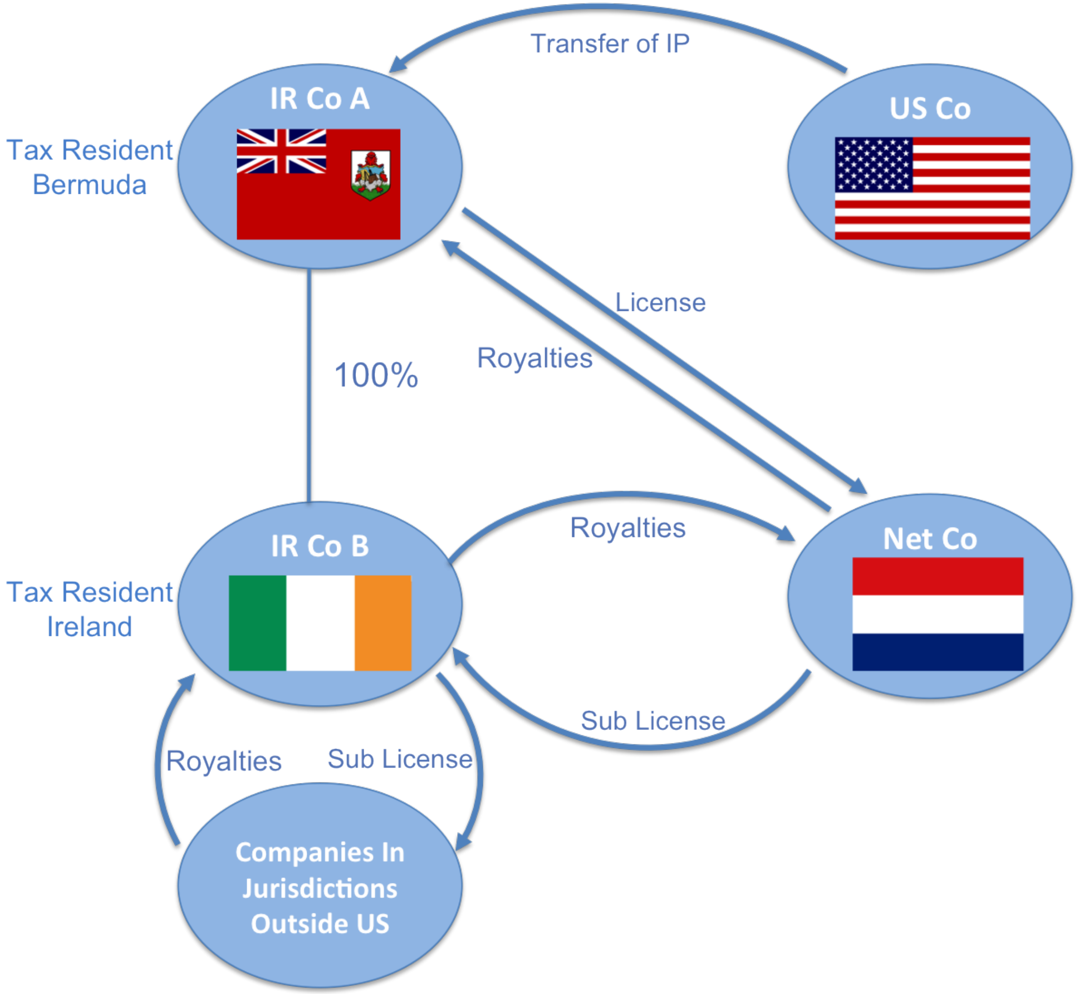
- Corporate taxes of most countries are source-based (with some residence elements, e.g., 10.5% GILTI minimum tax in US)

- Source-based taxation $\rightarrow$ incentives to move production and shift profits to tax havens

2 Profit shifting

Three ways to shift profits to low-tax countries:

- Manipulating intra-group import and export prices (*transfer prices*)
- Intra-group borrowing
- Locating intangibles in tax havens

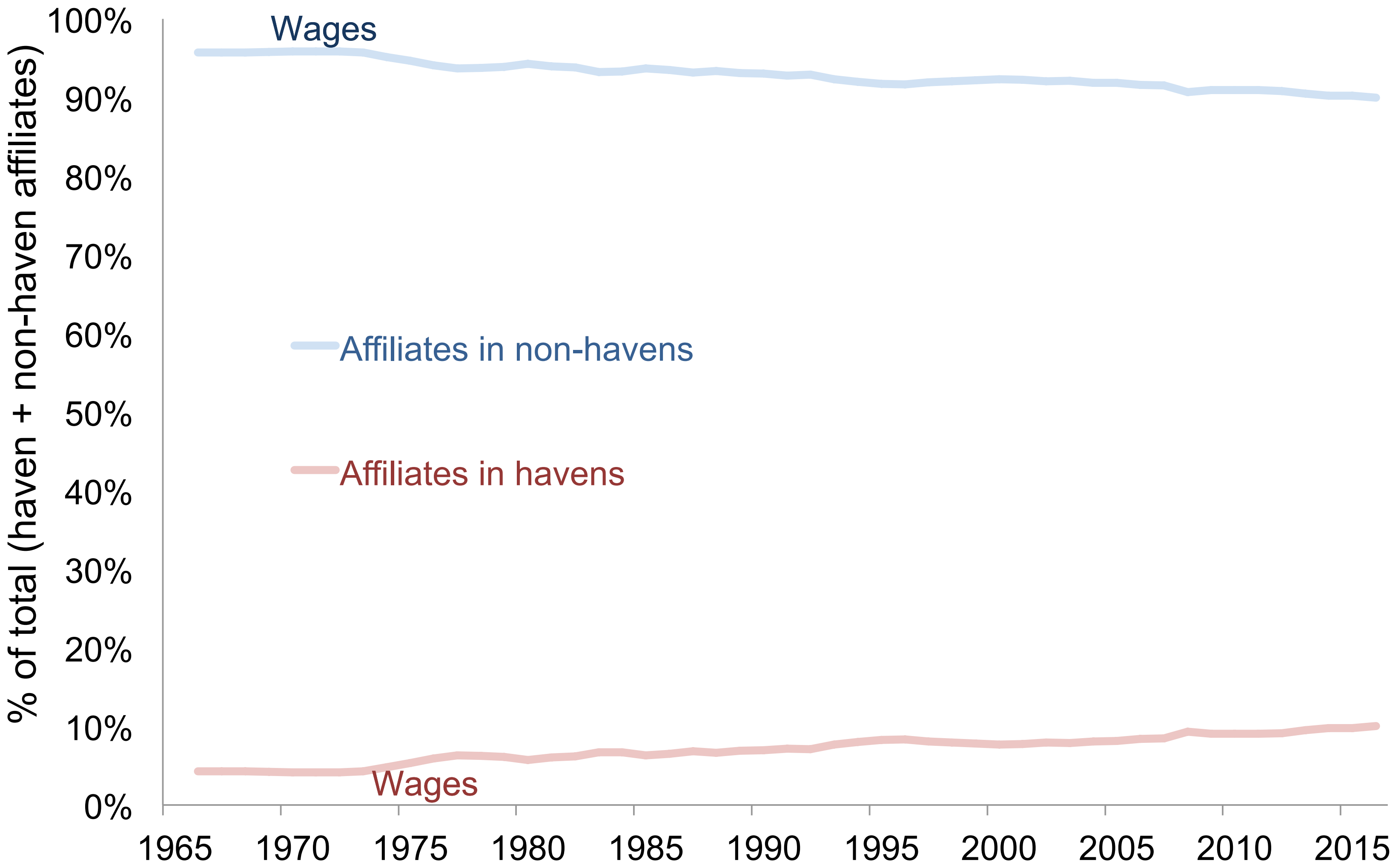


The Double Irish Dutch Sandwich

Capital mobility vs. profit shifting: the case of US multinationals

Quantitatively, how does capital mobility and profit shifting compare?

- Particularly good data for US multinationals back to 1966
- Profit shifting swamped capital mobility, though capital mobility a growing issue


% of total (haven + non-haven affiliates)
100%
90%
80%
70%
60%
50%
40%
30%
20%
10%
0%
Wages
Affiliates in non-havens
Affiliates in havens
Wages
1965
1970
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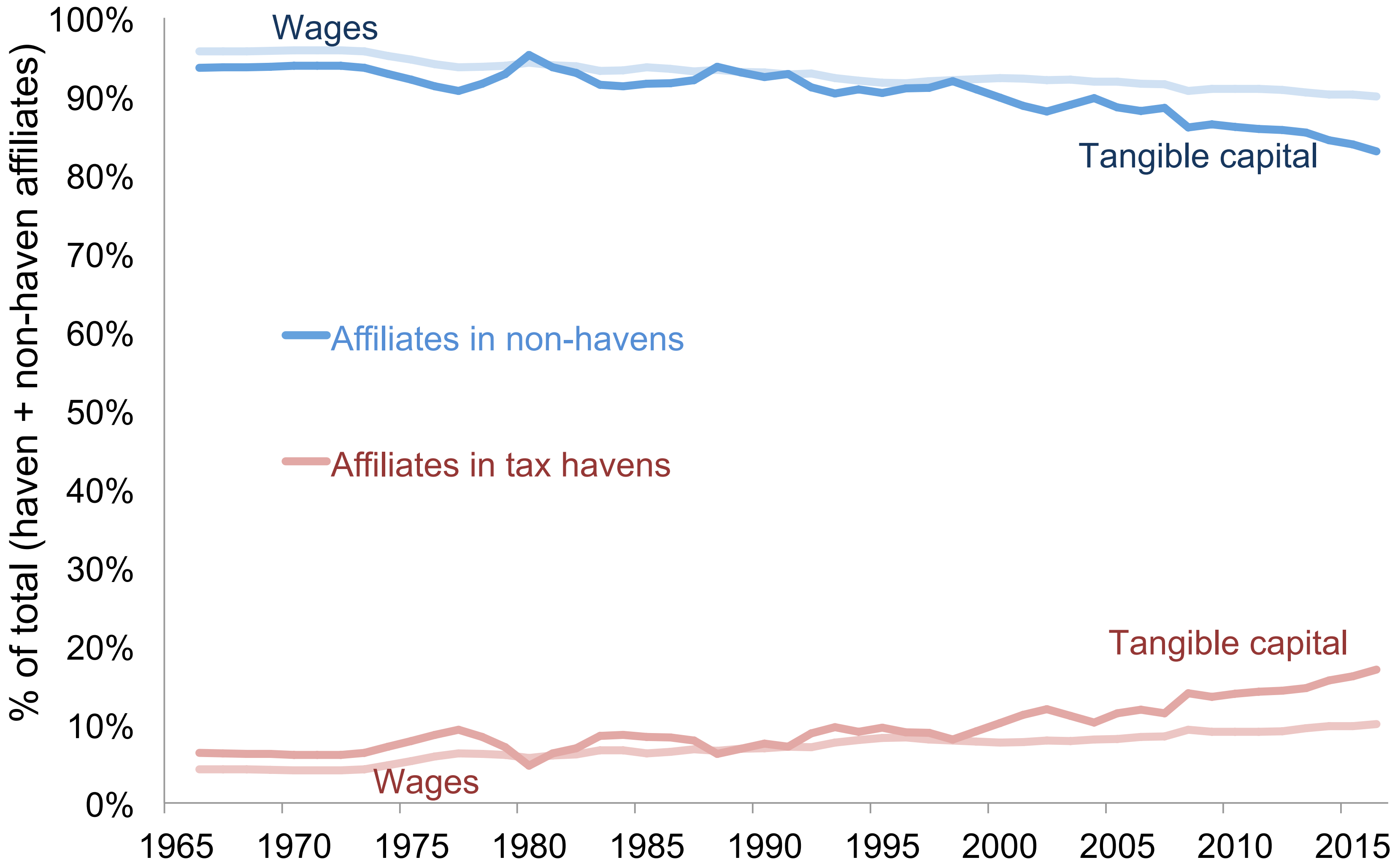

Wages
Tangible capital
Affiliates in non-havens
Affiliates in tax havens
Tangible capital
Wages
% of total (haven + non-haven affiliates)
100%
90%
80%
70%
60%
50%
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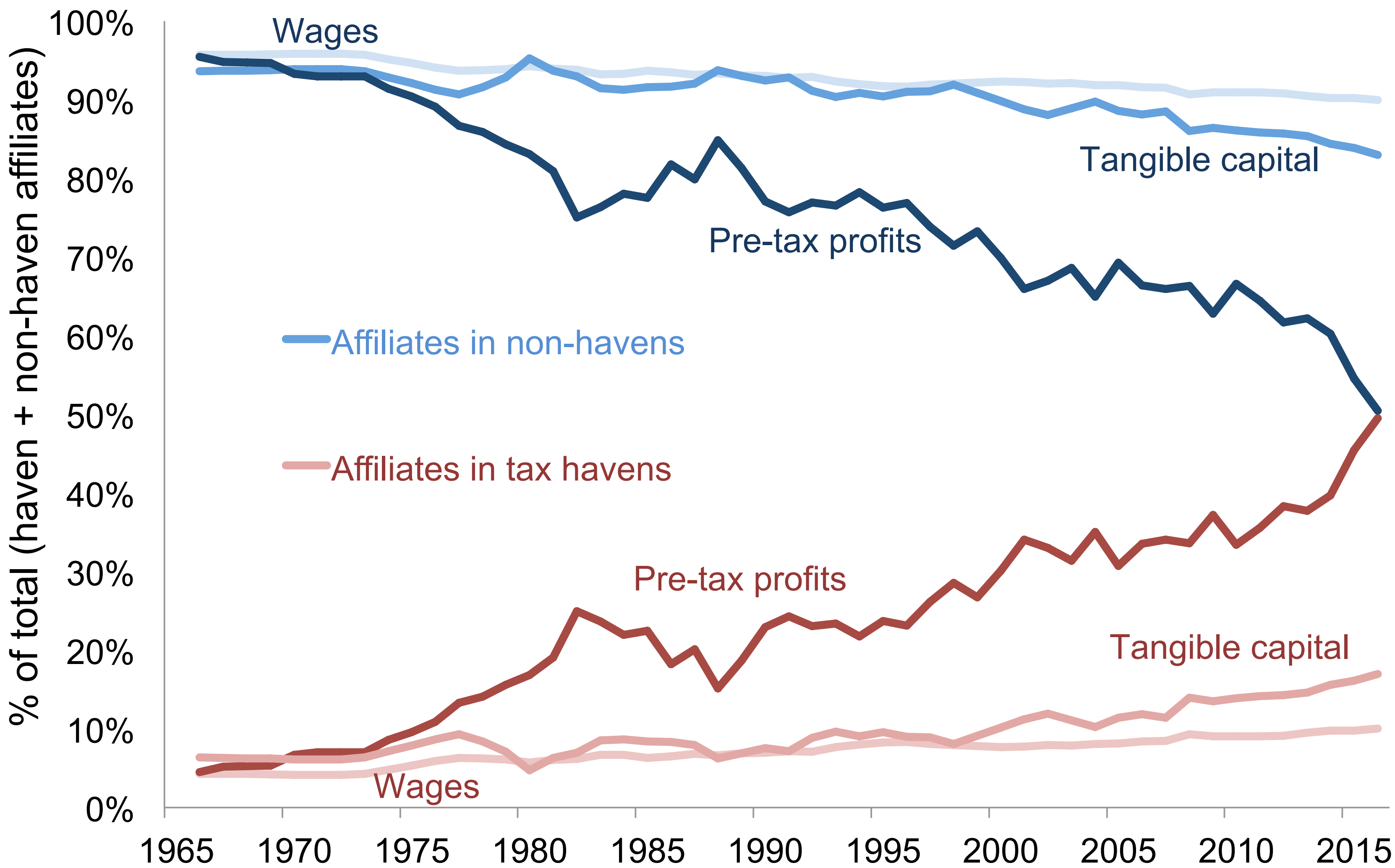

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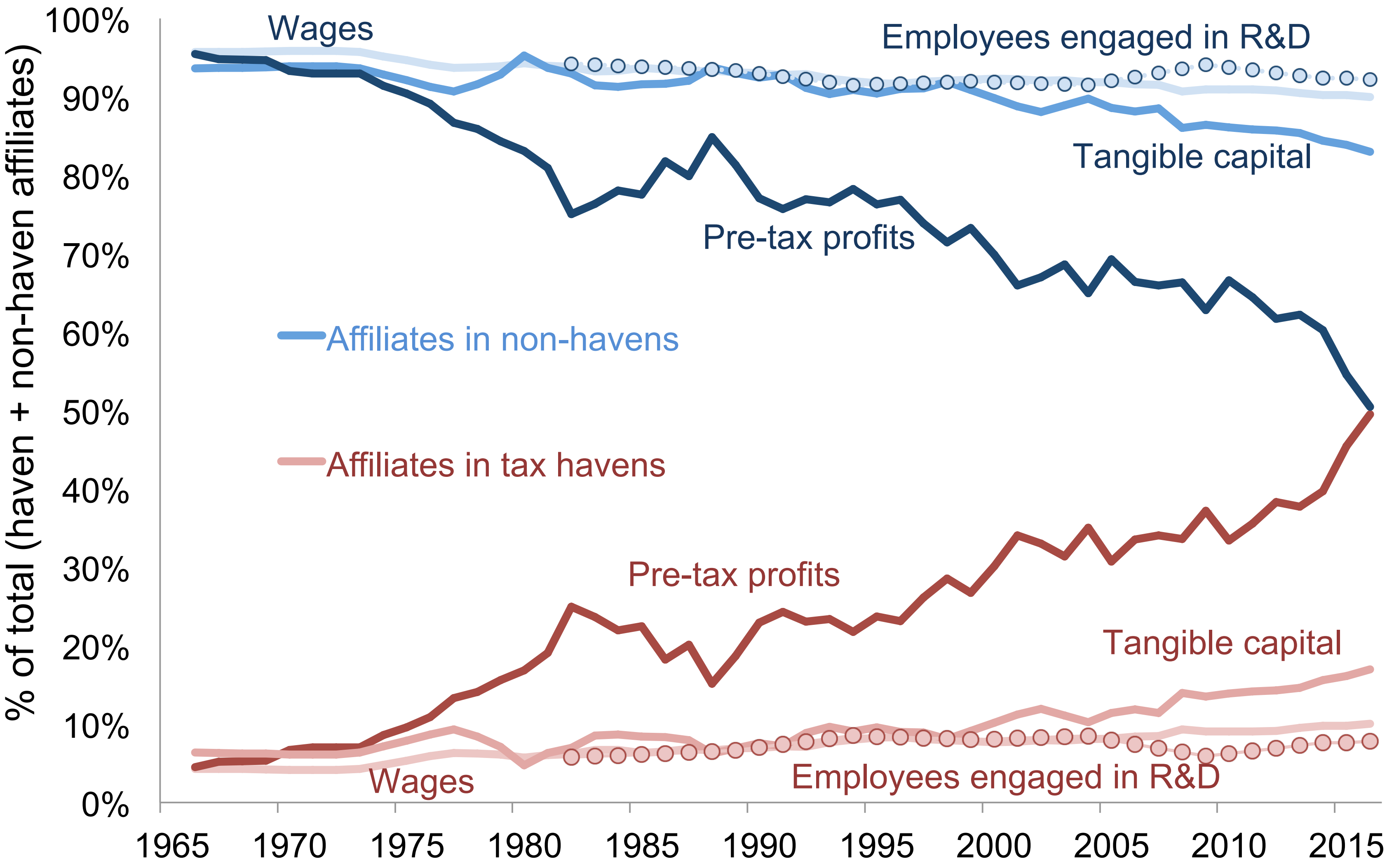
Wages
Tangible capital
Pre-tax profits
Affiliates in non-havens
Affiliates in tax havens
Pre-tax profits
Tangible capital
Wages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2000
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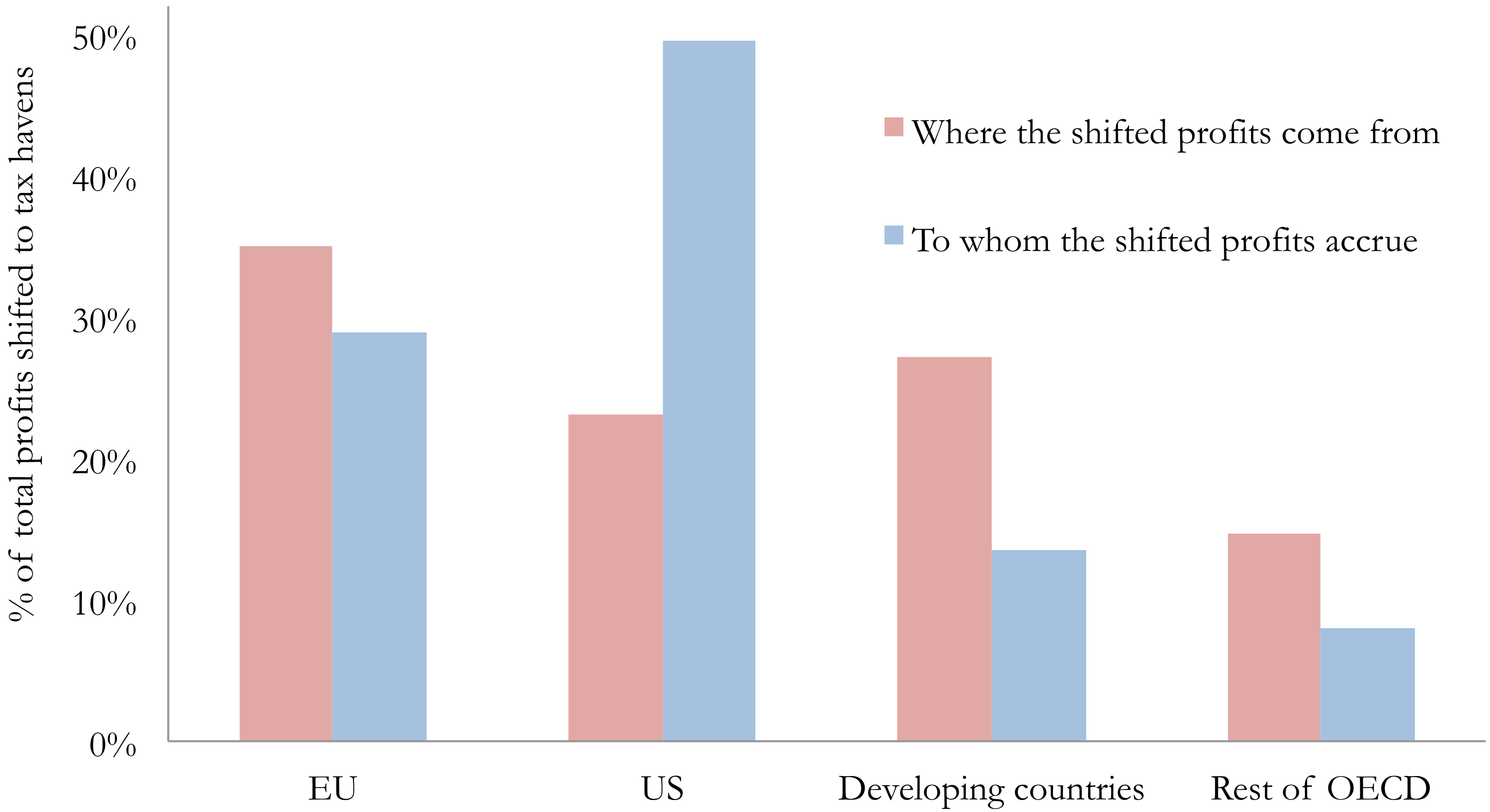
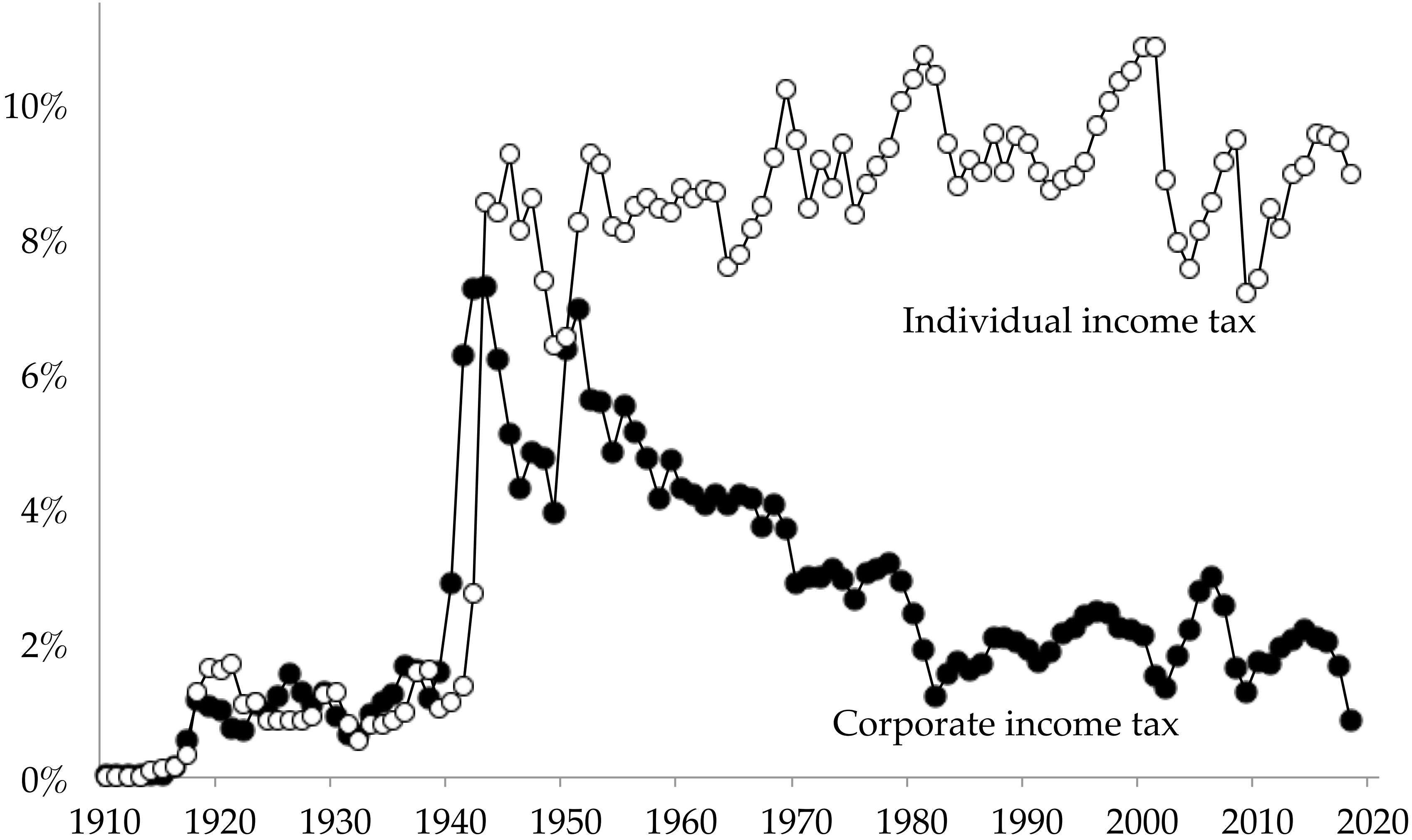
2010
2015
Wages
Employees engaged in R&D
Tangible capital
Pre-tax profits
Affiliates in non-havens
Affiliates in tax havens
Pre-tax profits
Tangible capital
Wages
Employees engaged in R&D

Allocating the profits shifted to tax havens



Source: Torslov et al. (2018).

Federal tax revenue (% of national income)



Policies to prevent profit shifting

OECD Base and Erosion and Profit Shifting (BEPS):

- Fixing inconsistency in bilateral tax treaties
- Strengthening arm's length rules
- Country by country reporting (not public)

BEPS 2.0

- Specific profit split for digital industries, based in part on location of users

- Discussion of minimum country-by-country tax rates

- Stalled before new US administration 2021

Renewed impetus for minimum taxation (April 2021)

- Biden / Yellen proposal

- Idea: US collects tax deficits of its multinationals (with 21% rate), other countries would do the same

- Could be transformative: removes incentives for firms to book income or locate assets in tax havens

Corporate tax integration

- Shareholders receive credits for previously paid corporate taxes

- Corporate tax becomes like a withholding pre-paid tax that is refunded when dividends are paid out to individuals

- Removes incentives to shift profits and move capital abroad

- Existed in Europe; still exists today in Canada, Mexico, Australia

- Can be combined with high minimum tax to ensure proper withholding at corporate level

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