BEPS, Spillovers, etc.: Current Issues in International Corporate Taxation

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See IMF (2014), “Spillovers in international corporate taxation”

Outline of what follows

- Context
- Does All This Matter?
- Importance for Developing Countries
- International Tax Spillovers
- A Different Architecture?
- Role of the IMF

Context

Why all the fuss?

- Public/policy makers' outrage at little tax paid by Google, Starbucks…
  - Main response is G20-OECD BEPS project.
- Though at the same time all want their system to be 'competitive'
- Perceived unfairness/distortions
  - Domestic vs. International firms
  - More vs. less aggressive tax planning multinationals
- Civil Society Organizations very active

The international tax ‘system’ is broken…

- Core principle is ‘arms length pricing’
  - Allocate profits across group by using prices unrelated parties would have reached
- System established in 1920s, when
  - Investment mainly between advanced countries, little intra-company trade, intangibles unimportant
- Such multilateralism as there is in tax matters under stress
  - Some cancellation of treaties

Three intertwined issues

- Tax avoidance
  - Exploiting rules to reduce liability

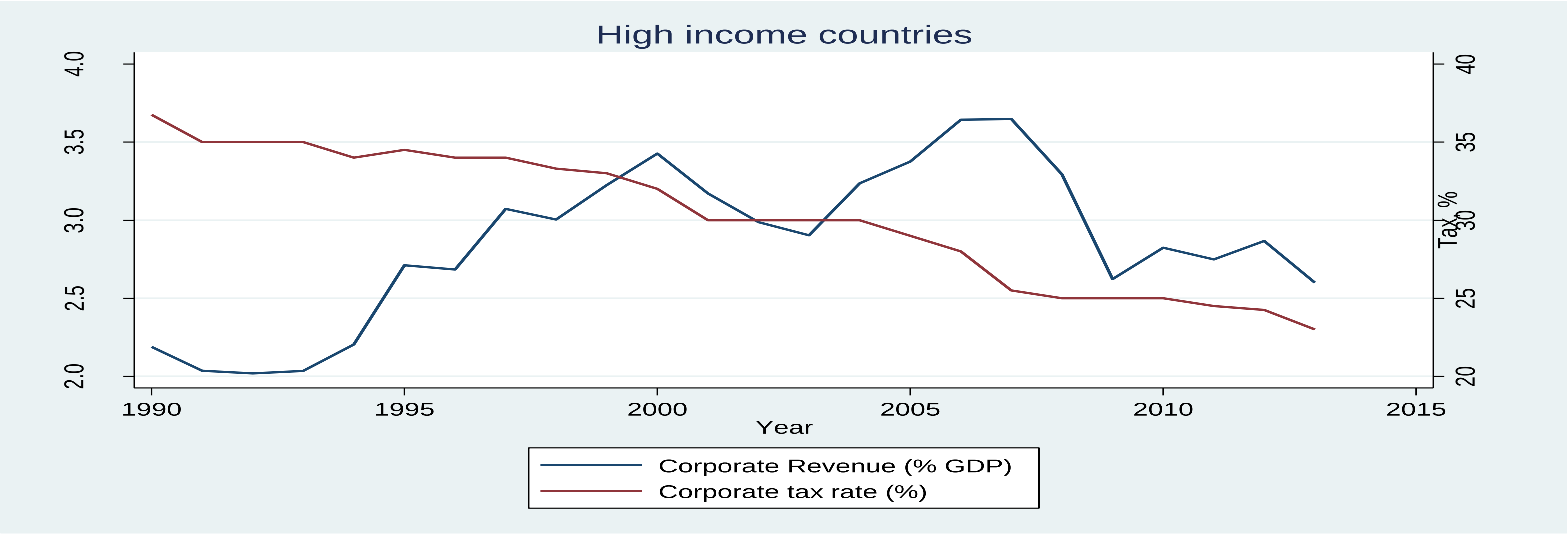
  The focus of the G20-OECD BEPS project

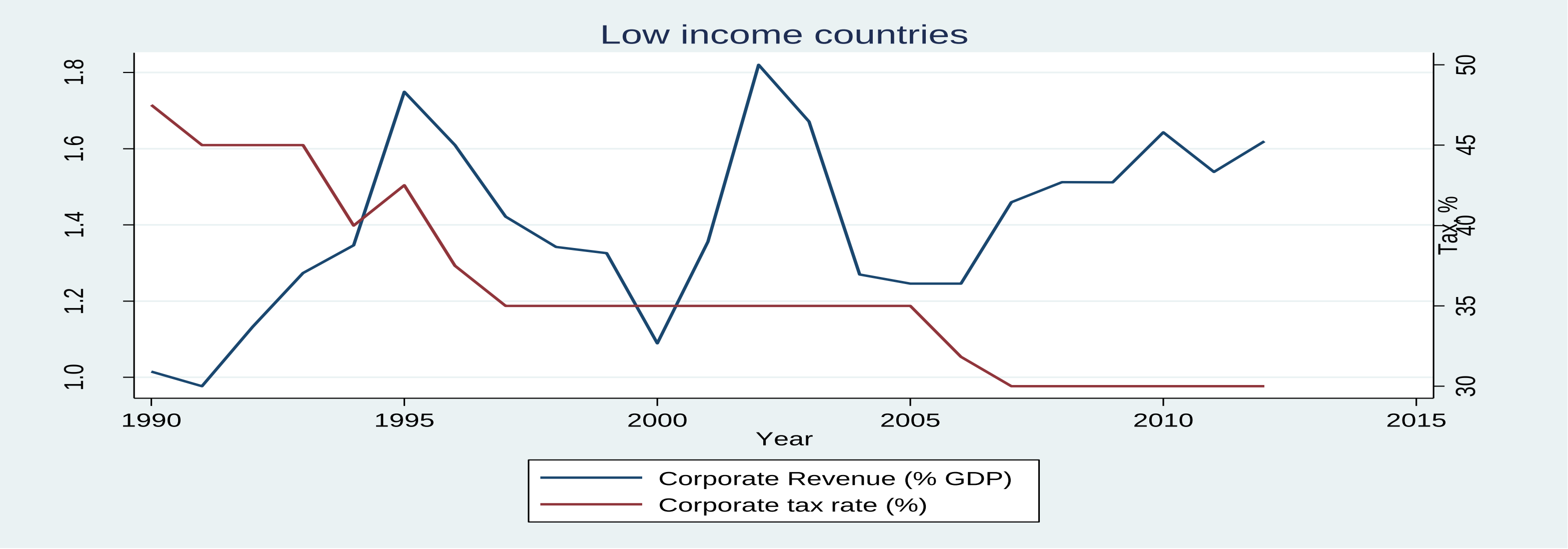
- Tax competition
  - Strategic tax setting by governments to reflect and exploit real and/or avoidance responses

  An overarching issue—discussed last year

- Structure of the international tax system

Perspective: CIT rates and revenue





Does All This Matter?

Could erosion of CIT be a good thing? (1)

- In small economies, source-based CIT acts as a distorting tax on labor
  - With fixed after-tax return, it simply increases pre-tax return, and real burden is on immobile factors

But if applied globally, maybe efficient tax largely on capital

And what revenue alternative in developing countries?

Could erosion of CIT be a good thing? (2)

- "Starve the beast"?
  - Fiscal rules better?

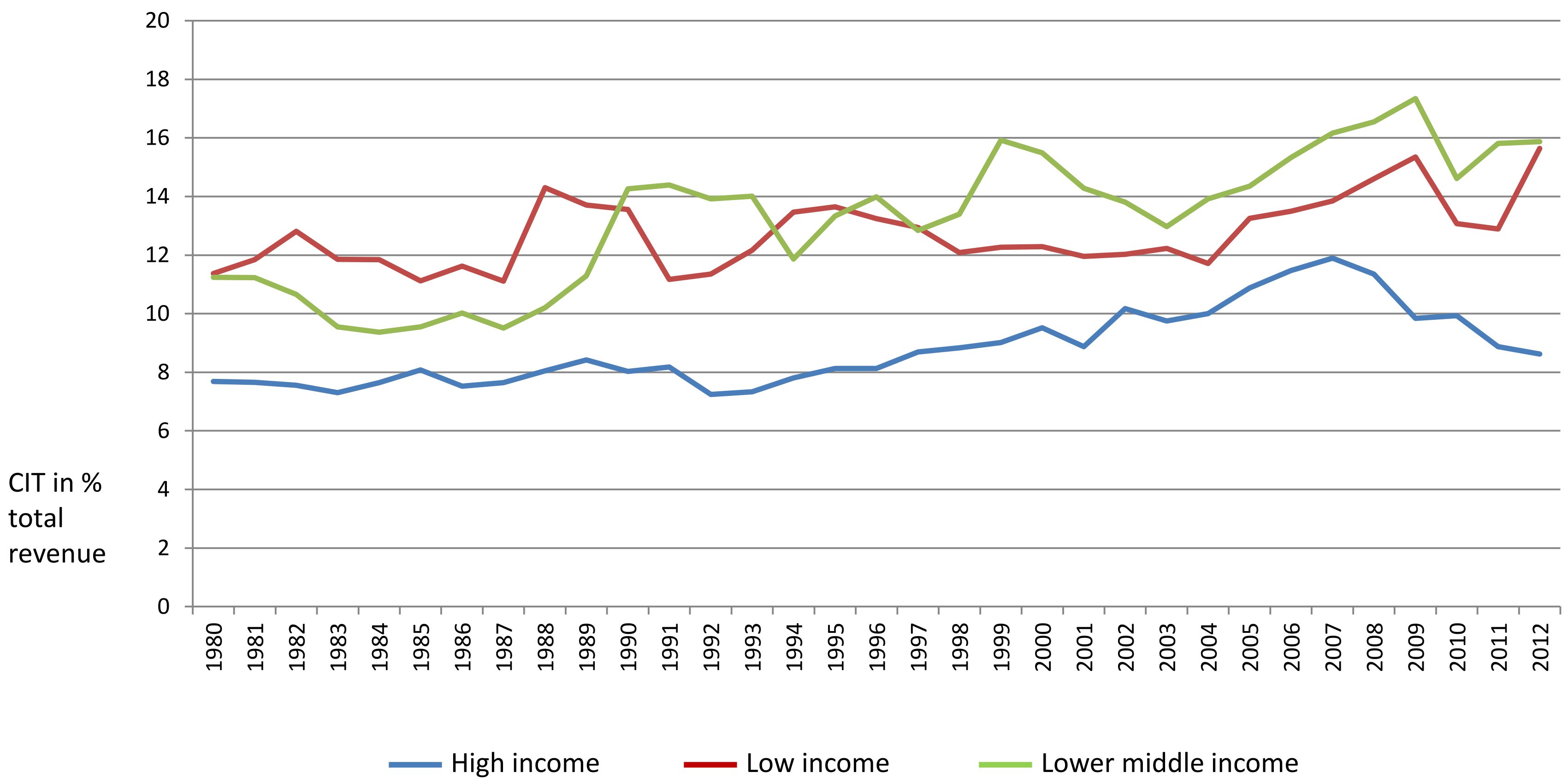
- Allows companies to escape CIT where most distorting (i.e. reduces marginal effective tax rates)
  - Some merit?
  - How assess 'success' of BEPS project?

How much revenue is at stake?

- Plenty of evidence that tax affects both FDI and profit shifting
- What is the revenue cost? Hard question: Beware simple answers
  - E.g. transfer pricing estimates
- CBO suggested about $60bn in U.S.
  - Roughly 25 percent of CIT revenue
  - Note other countries may be gaining revenue
- In some developing countries, single cases can be a large proportion of all revenue

Importance for Developing Countries

1. More reliant on CIT revenue

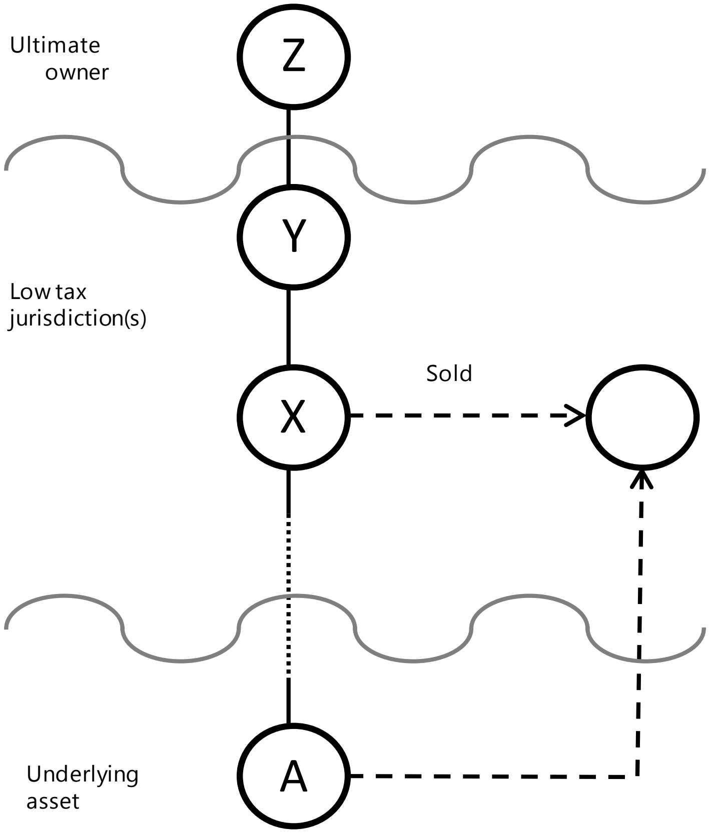


…and fewer alternative revenue sources

2. Even single cases can be macro-relevant

Most often in relation to "Indirect transfers of assets"

- Especially but not only in the extractive industries



3. Will come later!

International Tax Spillovers

Distinguish between

- Base spillovers: how one country's policy affects tax bases of others
  - Could be real or profit shifting
- Strategic rate spillovers: how one country's tax rate affects rates set by other
  - Simplest notion of tax competition
- Focus here on base spillovers

Previous work

- Large empirical literature
  - Significant effects on real investment
  - More recent work finds smaller profit shifting effects
- But almost all for advanced economies
  - Very little firm-level data for developing countries
- And has not distinguished types of base spillover

Types of base spillover

- Through real investment decisions
  - In this case, would expect spillover effect to be greater from ‘larger; countries
- Through profit shifting
  - In this case, expect spillovers to be larger from countries that it is easier to shift profits into/out of

Can we distinguish between these possibilities empirically?

Data

- Unbalanced panel of 173 countries, 1980-2013
- Calculate base (in percent GDP)as CIT revenue divided by the standard CIT rate
- ‘Tax havens’ from Gravelle (2013)
  - But information only on CIT arte, not special regimes

Full sample: Strong spillovers

	(1)	(2)	(3)	
CIT Base, lagged	0.7075***	0.7828***	0.7337***	
CIT rate *i*	-0.1747***	-0.1494***	-0.0839**	-
CIT rate *j*, weighted GDP	0.3211**			
CIT rate *j*, simple average		0.1220*		
CIT rate *j*, weighted tax havens			0.2973***	
M1 (p value)	0.000	0.003	0.000	
M2 (p value)	0.303	0.593	0.860	
Over -identification Hansen (p value)	0.710	0.620	0.272	
Observations	1547	1580	1570	
Number of countries	102	103	103	

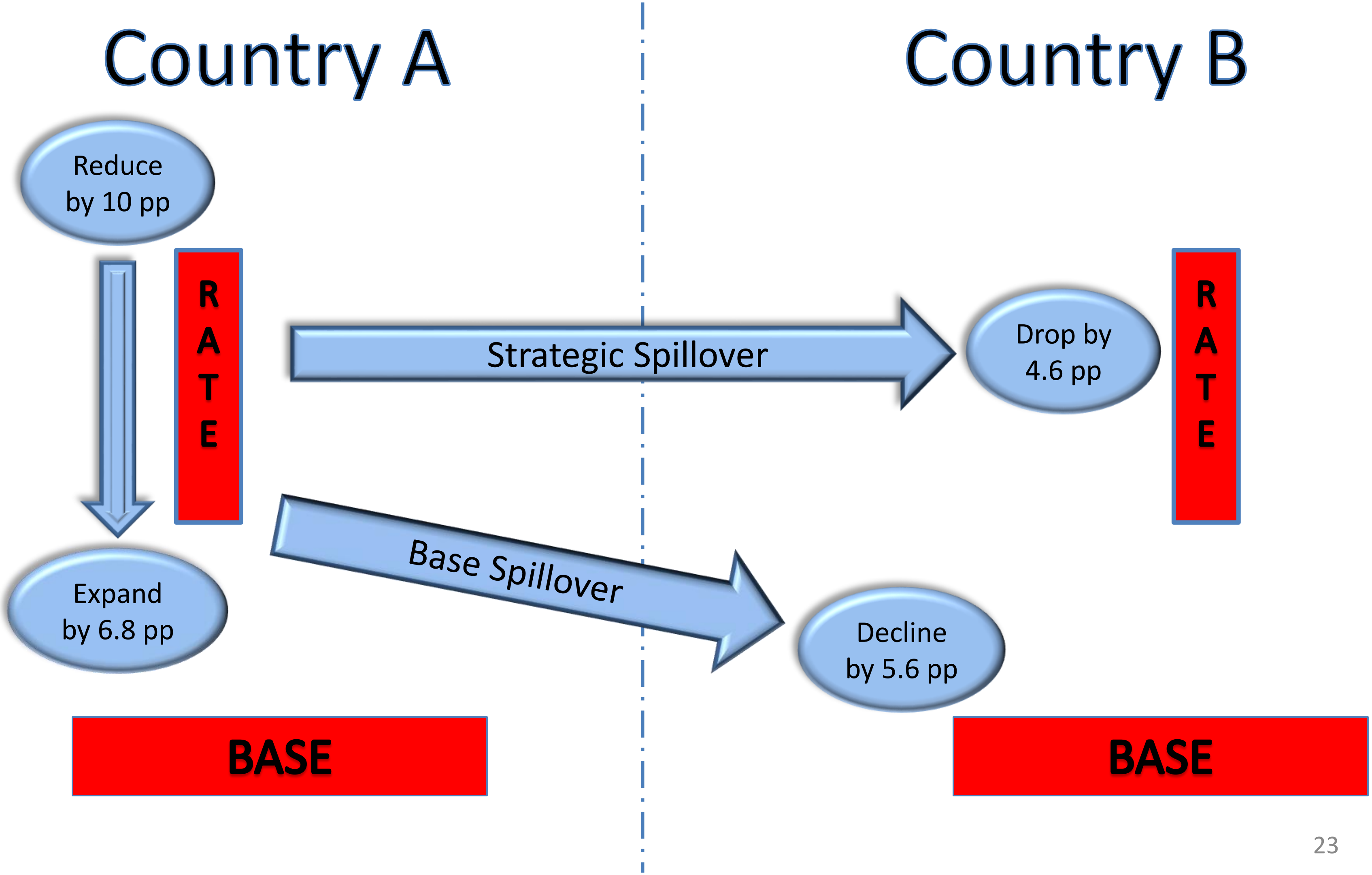
3. Spillovers seem especially strong for developing countries

	All	OECD	Non-OECD	Low and Middle Income
	(1)	(2)	(3)	(4)
CIT Base, lagged	0.7337***	0.6041***	0.5271***	0.4994***
Own CIT rate	-0.0839**	-0.0747*	-0.1649***	-0.2580***
Spillover	0.2973***	0.1051*	0.2908**	0.3119**

Source: Crivelli, de Mooij and Keen (2015): revising IMF (2014).

Note: Spillover is from 'haven-weighted' tax rates.

Illustrating



Summarizing empirical findings

- Base and rate spillovers commonly significant and (implausibly?) large
- If anything, stronger on lower income countries
- About as strong through real and profit shifting channels
- But many caveats….

A Different Architecture?

Worldwide taxation without deferral?

No scope for profit shifting if pay residence country’s rate on all income immediately

But:

- What welfare significance does a company’s ‘residence’ have?
- Residence can’t be taken as fixed…
- …and becoming harder to define
- And world has been moving in opposite direction

Formula Apportionment (FA)…

Allocates an MNE’s profits not by ALP but by sharing consolidated profits by indicators of activity in each, such as shares of sales, assets, payroll

—so transfer pricing issues go away (it seems)

- As for U.S. states, Canadian provinces—indeed all subnational CITs have a formulaic element

  …and proposed for EU by the Commission (CCCTB)

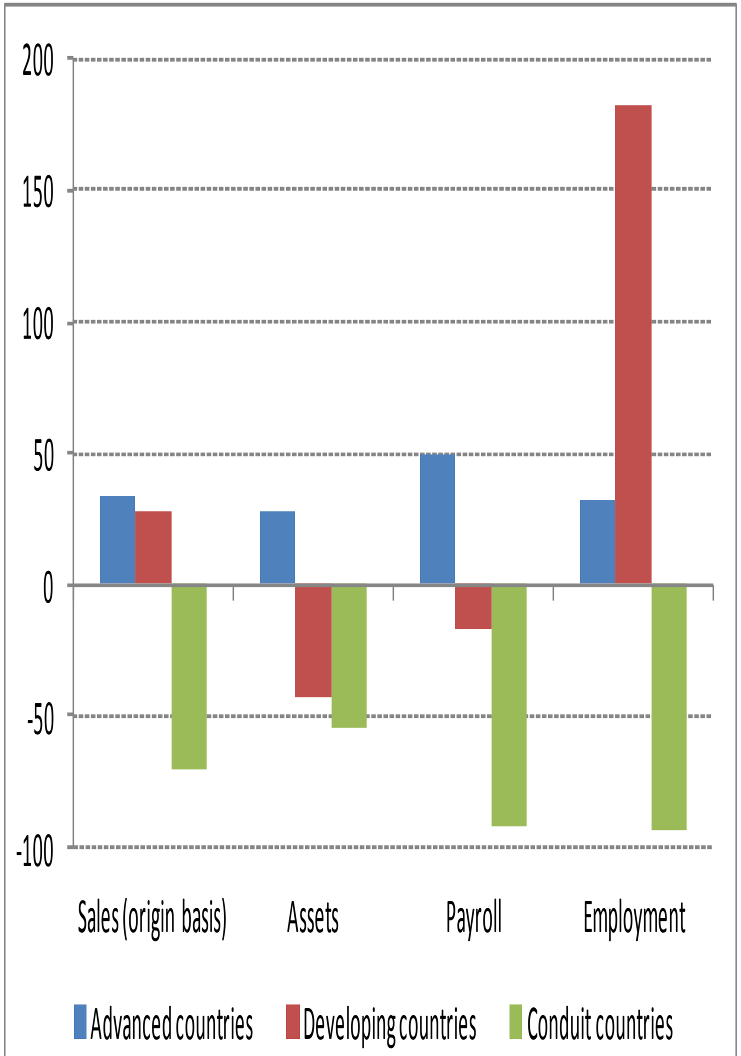
  —which at least suggests where a globalizing world may be headed

…some pros and cons

- Removes need to value intra-firm transactions

BUT

- What weights?
- Can distort ownership patterns
- Game playing by companies to affect weights
- Tax competition simply takes a different form—and maybe more aggressive
- ALP still needed if FA applies only to 'water's edge'



(A thought)

- ‘Substance’ tests have a formulary spirit
- Where tax amount involved is large, establishing an artificial presence may be attractive…
- …In which case, is anything gained?

Residual formulary profit split

(Avi-Yonah et al)

- Use third party prices where available..
  - E.g. fixed mark up on such purchases

  …and apportion 'residual profit' that remains (by sales?)

Little studied, but, e.g.,

- Can have positive liability when group makes loss
- But may lead to less intense tax competition

Destination-based corporate tax

(Auerbach, Devereux and Simpson)

E.g. a cash flow tax but (a) exclude receipts from exports and (b) no deduction for imports

- Effectively a VAT plus wage subsidy
  - and hence has attractive neutrality properties: e.g. transfer prices irrelevant

- No tax competition issue

- But then why not a VAT plus lower labor tax?

Role of the IMF

Exploiting comparative advantage

- Technical assistance
  - Over 90 countries per year
  - Much advice on international tax aspects, in holistic context wider reforms
- Involvement in selected BEPS toolkits
- Analytical work, e.g.
  - 2014 Board paper
  - Book on international tax issues for EIs in process
  - Technical notes, analytical papers

References

Avi-Yonah, R., K. A. Clausing, and M. C. Durst, 2009, "Allocating Business Profits for Tax Purposes: A Proposal to Adopt a Formulary Profit Split," *Florida Tax Review*, Vol. 9 (5), pp. 497–553.

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