

US Multinational Enterprises and Profit Shifting

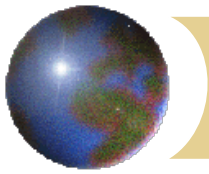
“International Tax Design for the 21st Century: Evaluating BEPS and Looking to the Future”

University of Melbourne and ANU (held online)

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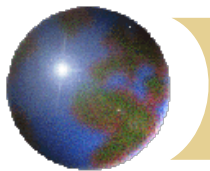
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Outline

- The magnitude of base erosion and profit shifting
 - Evidence from micro-data v. estimates from macro-data
- Anti-avoidance rules prior to the BEPS/Pillars project
 - Evidence on the strengthening of CFC rules and TCRs
 - Why are these not used (even) more widely?
 - Collective action problem v. benefits of haven use to nonhavens?
- The development of the Pillars project and the role of the US
 - “Ring-fencing” and targeting
 - The spectre of digital services taxes (DSTs)
- The (changing?) role of the corporate income tax (CIT)
 - Implications for the Pillars project



Empirical Evidence on BEPS

\$



Affiliate
(Low-tax)

Parent
(High-tax)

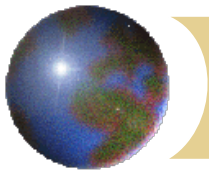
Income-shifting:

Suppose that the tax rate falls by 1 % point; how much more income will be reported by this affiliate?

e.g. Dharmapala (2014) survey:

“Consensus” estimate: semi-elasticity ≈ 0.8 using affiliate-year-level (“micro”) data from the Bureau van Dijk databases

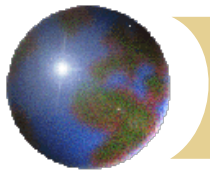
i.e. a 10 % point decrease in country i 's tax rate (e.g. from 35% to 25%) is associated with an 8% increase in reported income (e.g. from \$100,000 to \$108,000)



Empirical Evidence on BEPS: Summary

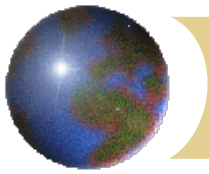
A 10% point decrease in a country's tax rate (e.g. 35% → 25%)
→ an increase in reported income of:

Study	%	e.g. from	to
Hines and Rice (1994)	22.5%	\$100,000	\$122,500
Huizinga and Laeven (2008)	13%	\$100,000	\$113,000
“Consensus” in Dharmapala (2014) survey	8%	\$100,000	\$108,000
Heckemeyer and Overesch (2017) meta-analysis	8%	\$100,000	\$108,000
Beer, de Mooij and Liu (2020) meta-analysis	10%	\$100,000	\$110,000

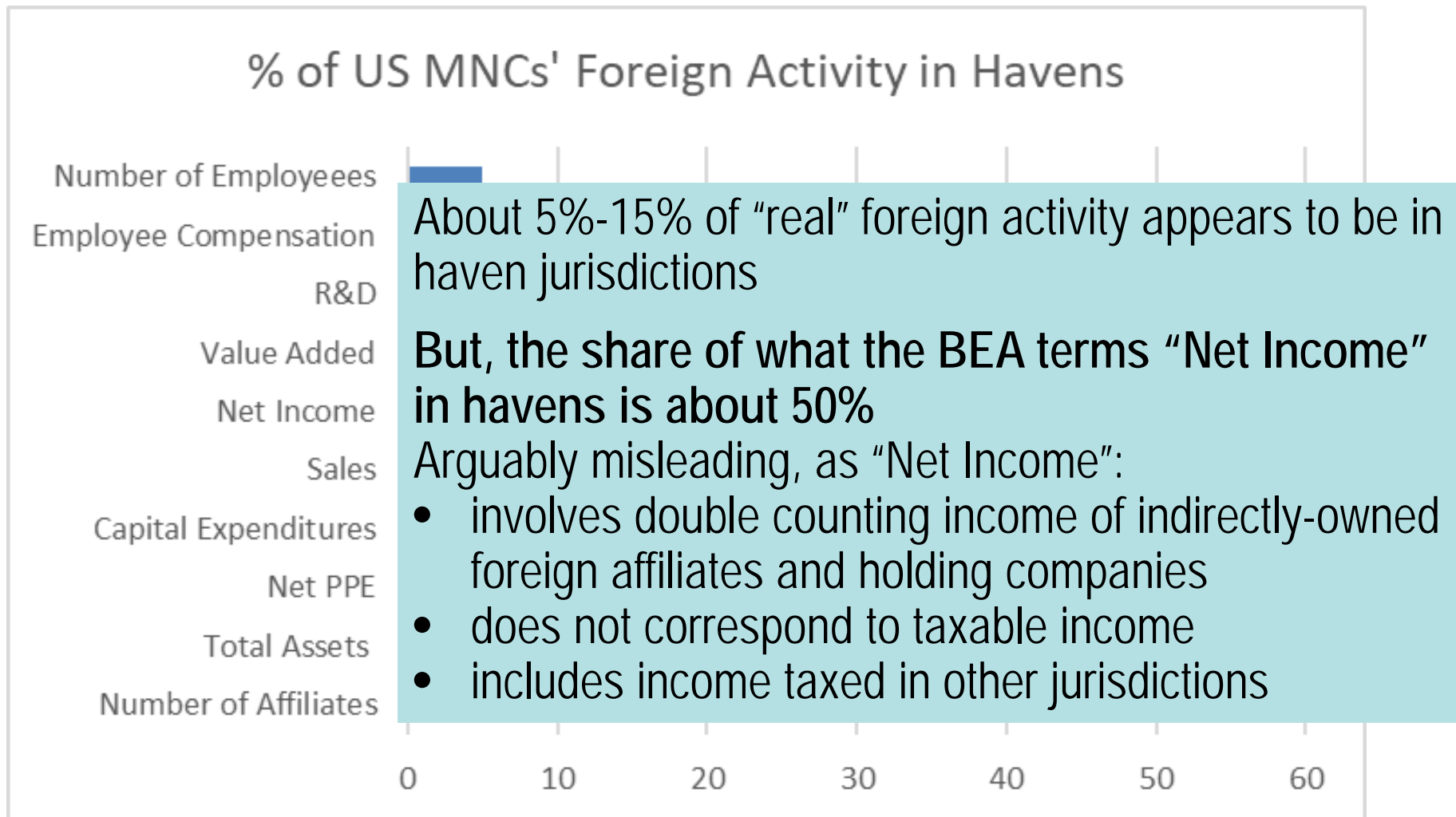


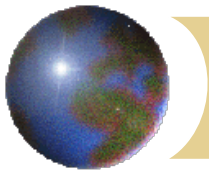
Empirical Evidence on BEPS: Issues

- The micro evidence → nontrivial but relatively modest magnitude of BEPS
- But, public concern about BEPS has focused on a handful of mostly US-based digital platform firms
 - Limited data on US MNE affiliates in standard databases
 - Limited data on tax haven affiliates in standard databases
- “Macro” approach using aggregate data
 - Clausing (2016)
 - Torslov, Wier and Zucman (2018)
- But, there are problems with the macro data as well



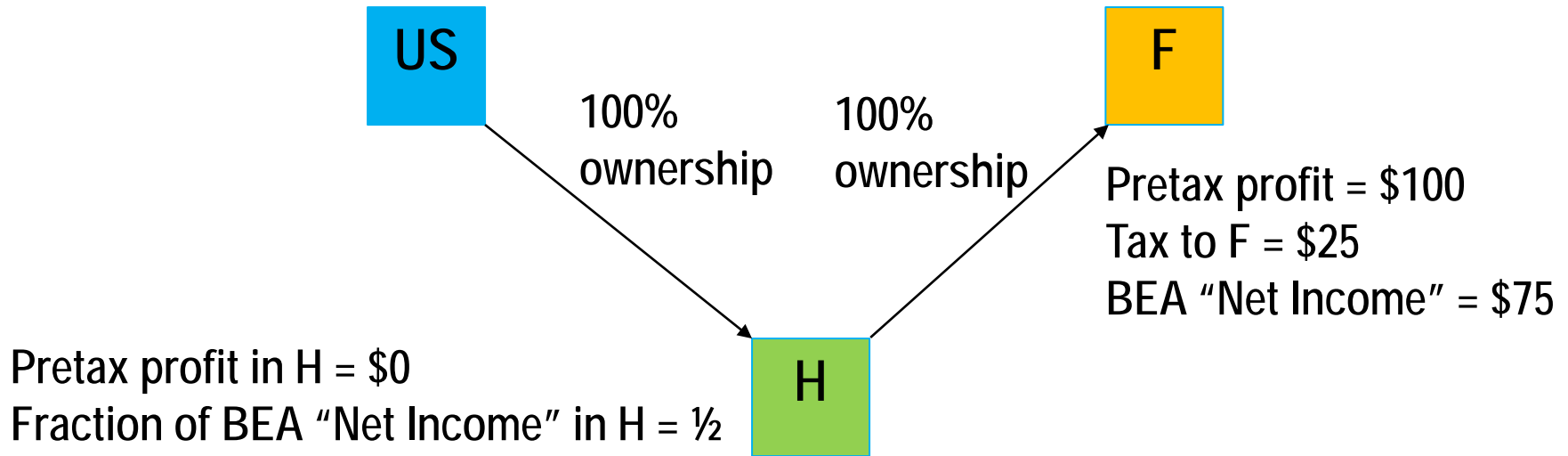
Share of US MNCs' Foreign Activity in Havens



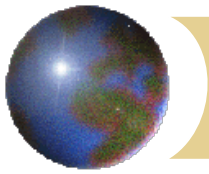


Share of US MNCs' Foreign Activity in Havens

Blouin and Robinson (2020): clarify how the BEA concept of "income from equity investments" leads to double counting



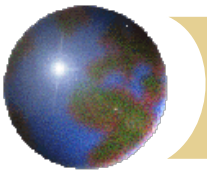
Correcting for this ↓'s Clausing's (2016) "estimate of the US fiscal effects of BEPS from 30-45% to 4-8% of corporate tax revenues lost to BEPS activity of MNEs"



Anti-Avoidance Rules Pre-BEPS/Pillars

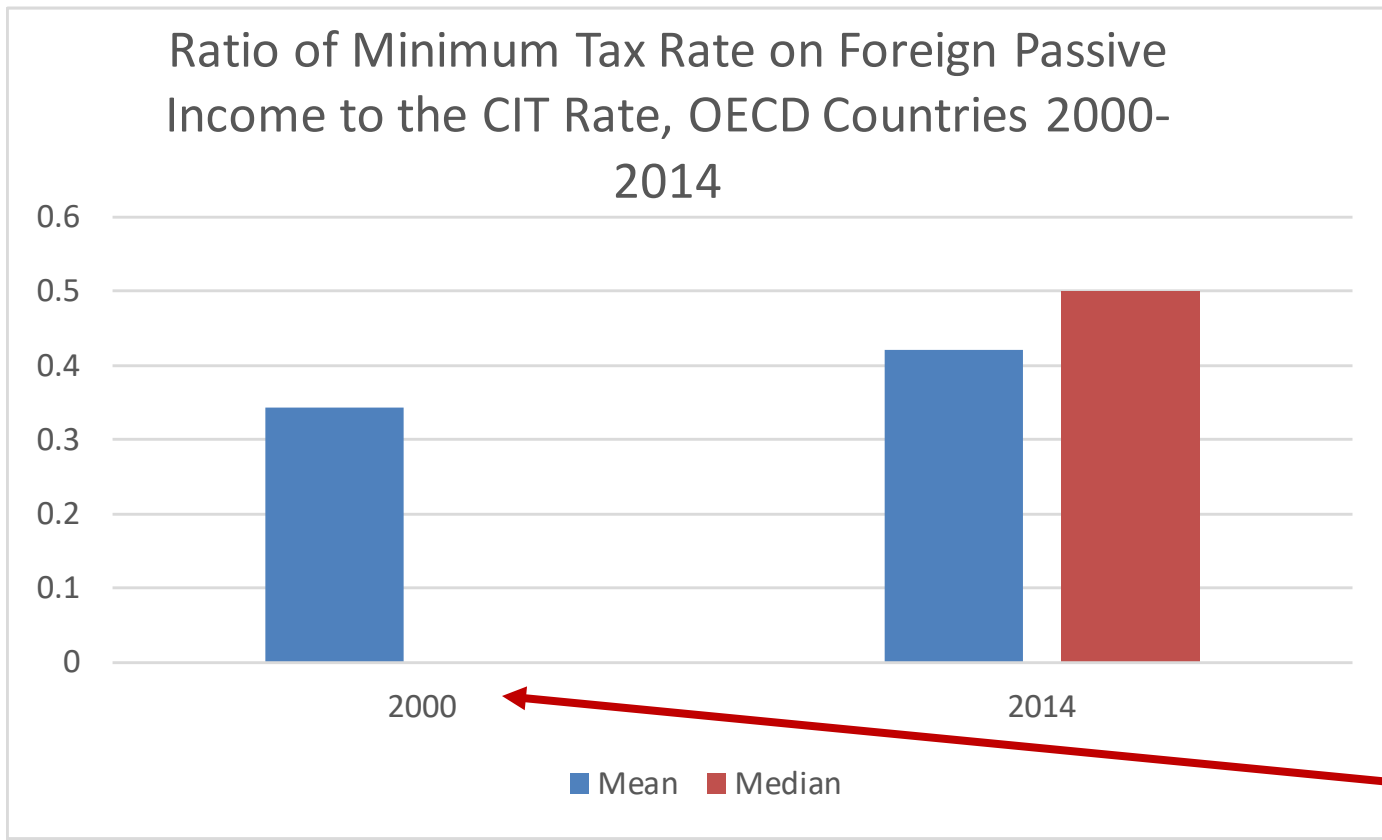
Nonhaven governments' tax law instruments:

- CFC rules:
 - Suppose residence country has tax rate τ_{it}^c
 - A CFC rule specifies τ_{it}^{min} s. t. a resident MNC earning passive income in country j (with tax rate τ_{jt}^c) pays:
 - τ_{jt}^c if $\tau_{jt}^c \geq \tau_{it}^{min}$
 - τ_{it}^c if $\tau_{jt}^c < \tau_{it}^{min}$
- Thin capitalization rules (TCRs) for interest deductions
 - Minimum equity/assets safe harbor ratio q_{it}
 - Deductions limited to fraction d_{it} of pretax income

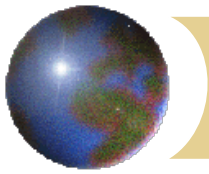


CFC Rules

- The use of CFC rules ↑ among OECD countries, 2000-2014
 - Infer residence countries' minimum tax rates on foreign passive income from CFC rules (absence $\rightarrow \tau_{it}^{min} = 0$)

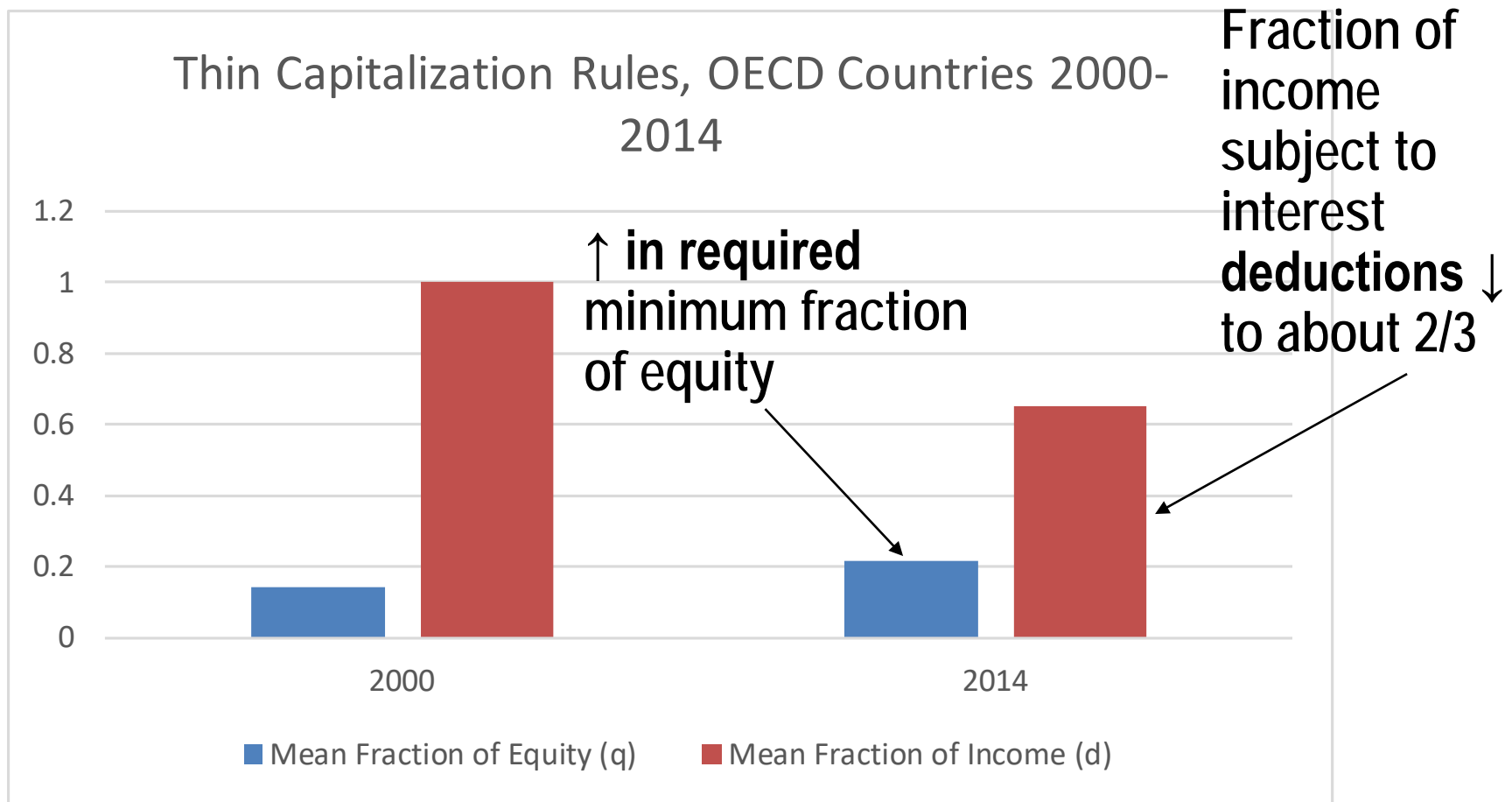


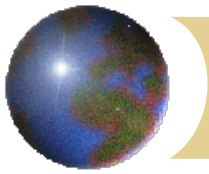
Median = 0
in 2000



TCRs

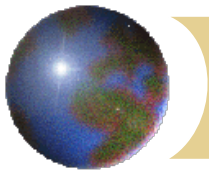
- Similarly, \uparrow in the strength of TCRs, 2000-2014





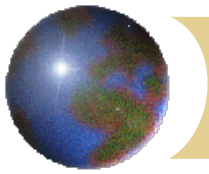
Multilateral Cooperation

- Why are these existing tax law tools not used (even) more extensively?
- Collective action problem?
 - CFC rules benefit other nonhavens by discouraging foreign-to-foreign shifting
- Possible scope for gains from multilateral cooperation
 - But, unclear whether the current agreement is self-enforcing
 - Countries already have powerful tax law instruments that neutralize MNEs' use of havens
 - Potential unintended consequences
 - Intensification of tax competition for "real" investment when there is less income shifting to havens



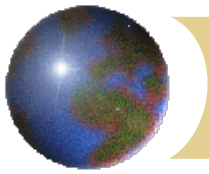
The Development of the Pillars Project

- BEPS project began with a focus on large digital platform firms
 - But, US objections to “ring-fencing”
 - Nationality discrimination? (Mason and Parada, 2020)
- → broader scope, affecting all MNEs
 - Over-broad?
- Portrayed as the only alternative to the proliferation of unilateral DSTs
 - But, while DSTs have many shortcomings, they are arguably better-targeted than the Pillars project



The US Approach

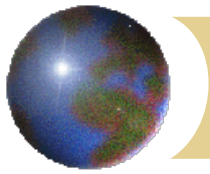
- 2017-2021 administration/regime: Two-pronged strategy:
 - **Bullying** other countries to abandon their DSTs
 - **Sabotage** of the multilateral process
 - e.g. seeking electivity of new provisions
- Current administration: multilateral approach
 - But, “appropriation” of the work of the Inclusive Framework?
 - Subordination to domestic policy agenda?
 - Promotion of the controversial GILTI provision as the model for a global minimum tax



Corporate Income Tax (CIT)

- A basic economic principle (Tinbergen, 1952): Optimal ratio of the number of policy objectives to the number of policy instruments is 1:1
- Yet, the CIT is a single instrument with multiple objectives:
 - Taxing the normal return to capital in the corporate sector → Low rate
 - Preventing the use of corporations as a shelter from the personal income tax (PIT) → Rate linked to PIT rate
 - Taxing location-specific rents (LSRs) → High rate

Decouple these functions, use different instruments for different aims?



Alternative Approach

The Pillars project does not solve the underlying tensions among the objectives of the CIT

- Today, risk-free rate of return $\rightarrow 0$, so income tax \approx consumption tax and “corporate shelter” argument is less powerful
- Rents earned by domestic shareholders can be taxed by PIT

Thus, some (e.g. Cui, 2021) argue that the CIT is best understood as an attempt to tax foreign shareholders’ LSRs

If so, is the CIT the best way to do so?

- v. sector-specific taxes?
- Australia: long history of sector-specific taxes on mineral extraction – lessons for this debate?