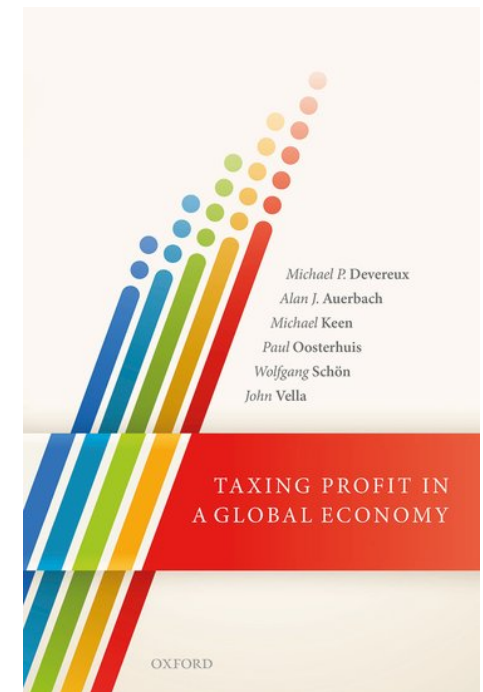


Some Selective Evidence and Policies Relevant to International Competition over Profit Taxes

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Plan

- What aspects of international tax are currently coordinated and uncoordinated?
- What might countries compete for, and how?
- How can we test for competition?
- How do current proposals address competition?

International coordination: legal form



Over 3,000 bilateral treaties

- Largely based on the OECD model (but also UN)
- Apply only to taxes on “income”
- Generally limit taxing rights for each country
- Rights generally defined in terms of “residence” and “source”

Exchange of information

- *Global Forum on Transparency and Exchange of Information for Tax Purposes* set up in 2009
- Common reporting standards in 2014

Also regional agreements, e.g. EU agreements on tax and state aid

Existing system

The 1920s compromise ...

- ▀ Tax “active” income in country of “source”
- ▀ Tax “passive” income in country of “residence”
 - ▀ e.g. royalties, interest

But what do “source” and “residence” mean?

Where do we tax now?

**RESIDENCE OF
SHAREHOLDERS**

Worldwide

**HEADQUARTERS /
PARENT
COMPANY**

One location

AFFILIATES

Many locations

**Mostly tax
here**

SALES

Worldwide

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International non-coordination

Based on domestic law

- Tax rates
 - Including lower rates on mobile activities / profit
 - and withholding taxes
- Tax bases
- Anti-avoidance rules
 - e.g. CFC rules, interest limitations, transfer pricing regulations

All except where rights have been given up through international treaties

What might governments compete for?

- Inward investment
 - HQs, manufacturing, offices, R&D, etc
- Taxable income (revenue)
- To generate competitive advantage for their “own” businesses (shareholders)

Do multinationals respond to taxes: real location?

Meta-analyses of academic studies suggest large responses

- e.g. FDI has semi-elasticity of 2.5 w.r.t effective tax rate (Feld & Heckmeyer, 2011)

At individual level, distinguish extensive and intensive margins

As important: does inward FDI have beneficial effects (e.g. through wages, and spillovers to domestic firms)?

Do multinationals respond to taxes: profit shifting?

What is counterfactual?

- Typically, assume that profits should be located with e.g. employees and tangible assets

Estimates tend to higher using macro data than micro data
(*Dharmapala, 2014*)

In UK (*Bilicka, 2019*):

- Subs of foreign MNES underreport taxable profits by 50% (relative to domestic firms)
- Declare zero taxable profit 50% of the time (compared to 20% for domestic firms)

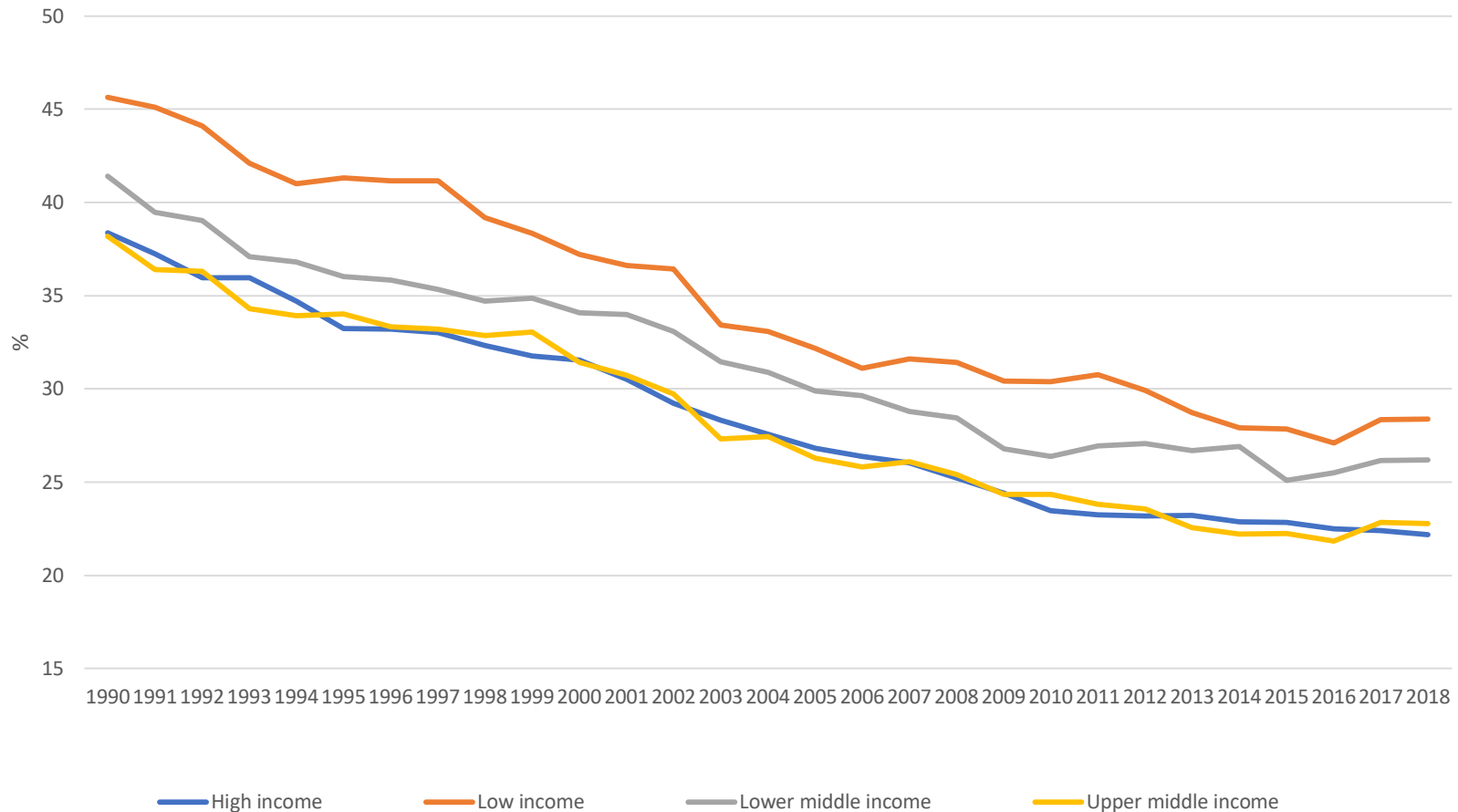
What might governments compete over?

What is fixed, what can be changed?

- Within existing structure, can compete over rates, bases, anti-avoidance rules
- Can countries compete over the structure itself?
 - e.g. California in early 1990s
 - DBCFT proposal in US in 2016 (and 2005)
 - Current OECD proposals for Pillars 1 and 2 aim for cooperative reform, partly to address competition

Competition? Equilibria or disequilibria?

All Countries: Average Statutory Corporate Income Tax Rate, 1990-2018



Source: IMF FAD Rates Database

Some basic difficulties in testing for competition

What predictions can be tested?

- Under-provision of public goods; zero rates?

Reaction functions: Does tax rate in i depend on tax rate in j ?

- What is j ?
 - Depends on form of competition (for profit, for investment, yardstick)
- Which tax rate?
- Can we find an exogenous change in tax rate in j ?
- Dynamics?
- Stackelberg leader?

Competition and fundamental reform

**RESIDENCE OF
SHAREHOLDERS**

**HEADQUARTERS /
PARENT
COMPANY**

AFFILIATES

SALES

Worldwide

One location

Many locations

Worldwide

Pillar 2

Pillars 1 & 2

Pillar 1

US: GILTI

RPAI

RPAI

US: Min tax

DBCFT

OECD Pillar 2: Halting competition?

Suppose MNE has subsidiary an *effective tax rate* less than e.g. 12.5%

- Then country of parent should tax that income (on accrual) to top tax up to 12.5%

“Substance-based carve-out” would mean

- That this would be targeted at profit shifted to haven, not the returns to real activity, so *not* targeted at general tax competition

Puts great strain on *legal residence* of parent company

An aside: Evolution of the US view

BEFORE: Competitive advantage for US companies

- Make it easy for them to pay little tax abroad
- “Check-the-box” and deferral

NOW: “Made in America Tax Plan” (April 2021)

- US companies are shifting activity (and jobs) abroad
- US will tax worldwide profits of US companies at 21%, with credit for taxes paid abroad
- That may create a competitive disadvantage, so advocate minimum tax worldwide (Pillar 2) at 21%
- Remove substance-based carve-out, targeting tax competition

Minimum tax and incentive compatibility

Classic cartel to keep prices (i.e. tax rates) high

- Why would countries agree?
- How can countries prevent other countries renegeing on deal?
 - *And how much does it matter if they do?*

Under-taxed payment rule (Pillar 2) and SHIELD (US)

1. If A buys good or service from related party B, and B's country not signed up, then A's country can withhold tax deduction
2. (US only, so far) Introduce new residence rule for "inversions" – companies US-resident if 50% owned by US citizens

Taxing in market country: removing the need for competition?

Tax where immobile factors located

- Consumers, shareholders, natural resources

Reduces

- Distortion to location decisions, profit shifting, spillovers
- So broadly incentive compatible

Limits incidence of tax on non-residents / citizens

Other issues: Path dependence

US states use a formula apportionment system:

- 1978: 43 out of 45 used three factor formula
- 2019: 37 out of 46 use sales only

But no comparable development internationally

- Formula apportionment not used
- Bilateral treaties

Other issues: Random effects

With enough observations we can control for unobserved random effects to try to identify underlying causal links

But what about a single worldwide agreement?

- May depend on many special, and possibly unobserved, factors
 - e.g. individuals