Principles for Reform

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International Tax Reform

Aims and Objectives

- Reduce susceptibility to avoidance and evasion
- Economic efficiency
- Fairness
- Ease of administration

Global v national perspectives

Why tax corporate profit at all? (1)

1. **Ability to pay: a proxy for personal income tax?**

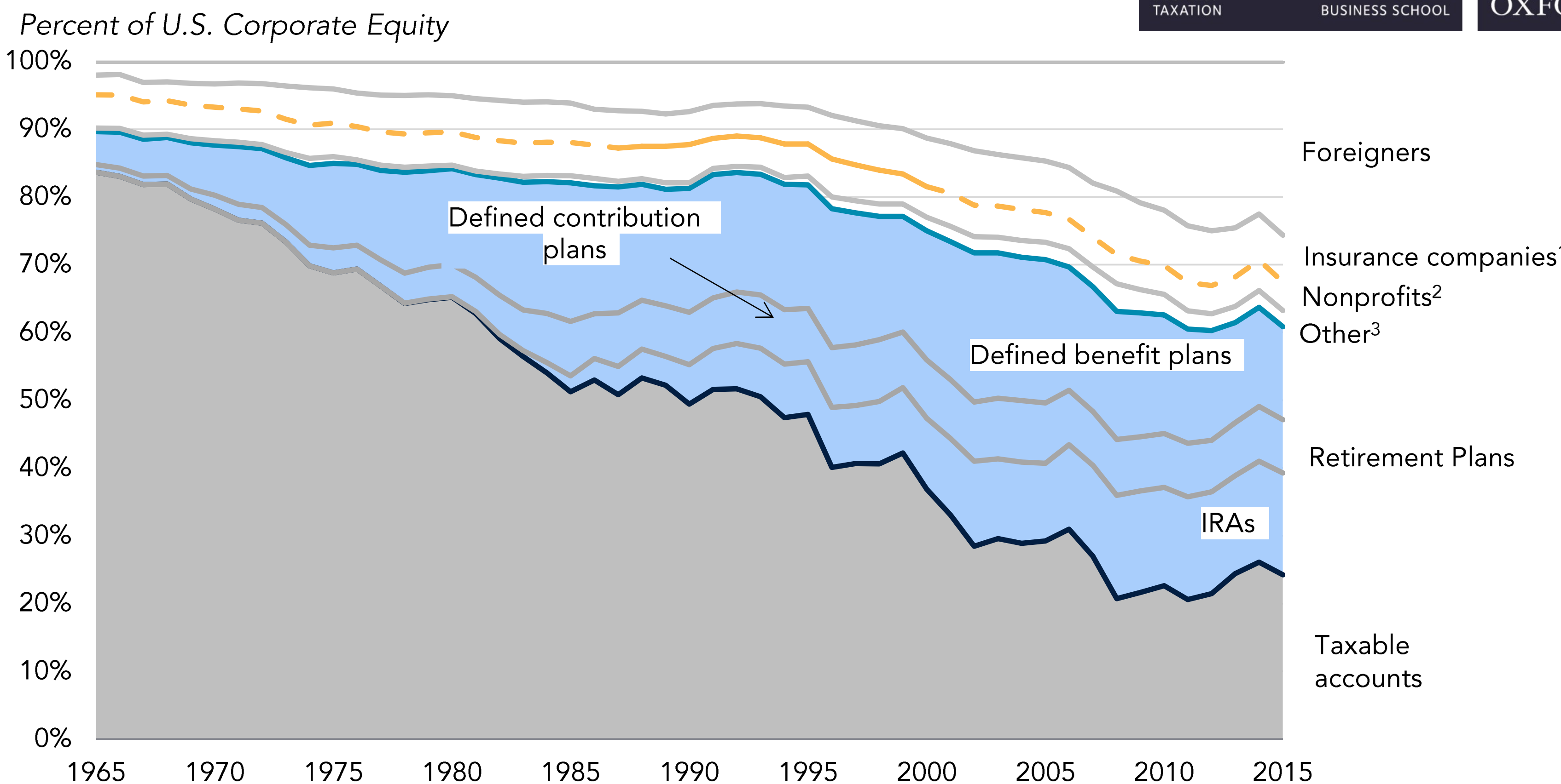
- Issues relating to
  - Tax exempt saving
  - Cross-border portfolio investment

- Existing corporation taxes broadly tax profit where economic activity takes place – not where owners live
  - See OECD BEPS

- See Toder-Viard proposal

Ownership of U.S. Corporate Stock, 1965-2015

Direct and Indirect Holdings



Source: Board of Governors of the Federal Reserve System, "Financial Accounts of the United States;" Investment Company Institute. 2016, "The U.S. Retirement Market, Fourth Quarter 2015;" Barclay Hedge; Preqin; Tax Policy Center calculations.

(1) Stock held in non-taxable segregated reserves to fund annuity contracts and whole life insurance.

(2) Dashed lines indicate authors' estimates

(3) Primarily government holdings, but includes equities in 529 savings plans.

Chart source: Steven M. Rosenthal and Lydia Austin, "The Dwindling Taxable Share of U.S. Corporate Stock." Tax Notes, May 16, 2016.

Why tax corporate profit at all? (2)

2. **Payment for publicly-provided goods and services**

- More closely associated with place of economic activity

- But is value and/or cost related to profit?
  - Why not a user charge?

Why tax corporate profit at all? (3)

Other possibilities

3. To tax foreigners?
4. Political – lower taxes on individuals?
5. We already have one?
6. Administration costs are lower in taxing business?
7. No reasonable alternative revenue source?

Designing an efficient tax

Given choice of location, an “efficient” tax base must be (relatively) immobile

- Some sources of economic rent may be immobile (“location-specific”)
  - eg. natural resources
  - But hard to identify and tax with a general tax

- Individuals are less mobile
  - So tax profit in residence of individuals
  - ***Shareholders or consumers***

Taxing profit in place of consumers?

Clearly different from existing standards

- Could argue that place of sale is a source of profit
  - Necessary, though not sufficient
- Also not a tax on personal income of shareholders, nor a place where publicly provided goods and services used in production
- But could generate improvements in efficiency, robustness to avoidance and costs of collection

Scope of reform

Should we:

- Identify a system from scratch, and then consider how to implement reform?

or

- Look for incremental improvements to existing system?
  - In any case, incremental reform should be consistent with a longer-term goal

Stability

Stability requires “incentive compatibility”

- Should be an incentive to join international consensus system
- Should ***not*** be an incentive to undermine taxes elsewhere
  - eg. through competition in tax rates

Reform options on the current political agenda

John Vella
Oxford University Centre for Business Taxation

A CORPORATE TAX FOR THE 21ST CENTURY

Washington

July 14, 2016

Three reform options

- BEPS
- Formulary Apportionment
- Strengthened Worldwide Taxation

BEPS

- **Final Reports**
- **Implementation**
- **Flaws**
  i. Fundamental structure unchanged
  ii. BEPS will not stop states from competing along a number of dimensions
     - Will competition on rates intensify? Recent reductions: France, Japan, Italy, UK
- **Conclusion**

International tax system will continue to be distortive, susceptible to avoidance, complex, incoherent, imposing huge compliance costs and susceptible to competition amongst states.

Formulary Apportionment

- **OECD vs NGOs & EU**
- **Variants**
  - Unilateral vs harmonized global adoption
  - Single vs multifactor formulas
- **Strengths**
  - **Harmonized globally**
    - No transfer pricing, debt shifting
    - Cross-border loss relief
    - Removes double taxation
    - Reduction in complexity and compliance costs
  - **Unilateral adoption**
    - Limits transfer pricing and debt shifting
    - Sales formula: does not discourage assets and labour

Formulary Apportionment

- **Weaknesses**
  - **Harmonized globally**
    - Distorts real activities (sales based formula mostly would not)
    - Competition on rates (unless sales based formula)
    - Sales factor effectively taxes use of business inputs
    - Susceptible to avoidance
    - Requires unlikely level of coordination
  - **Unilateral adoption**
    - Double taxation
    - Requires information on worldwide activity
    - Simplicity and reduced compliance costs lost as MNEs run two systems

Strengthened Worldwide Taxation

- **Options** (include)
  - Consolidate foreign subs with parent
  - Minimum tax on foreign subs’ profits
- **Strengths**
  - Reduces attractiveness of moving real activity / shifting income to low / no tax jurisdictions
  - TP issues less important
- **Weaknesses**
  - Conceptual
  - Resident companies at competitive disadvantage in foreign jurisdictions
  - Increases pressure on concept of residence
    - Incentive to invert / set up new companies overseas
  - Complex, high compliance costs