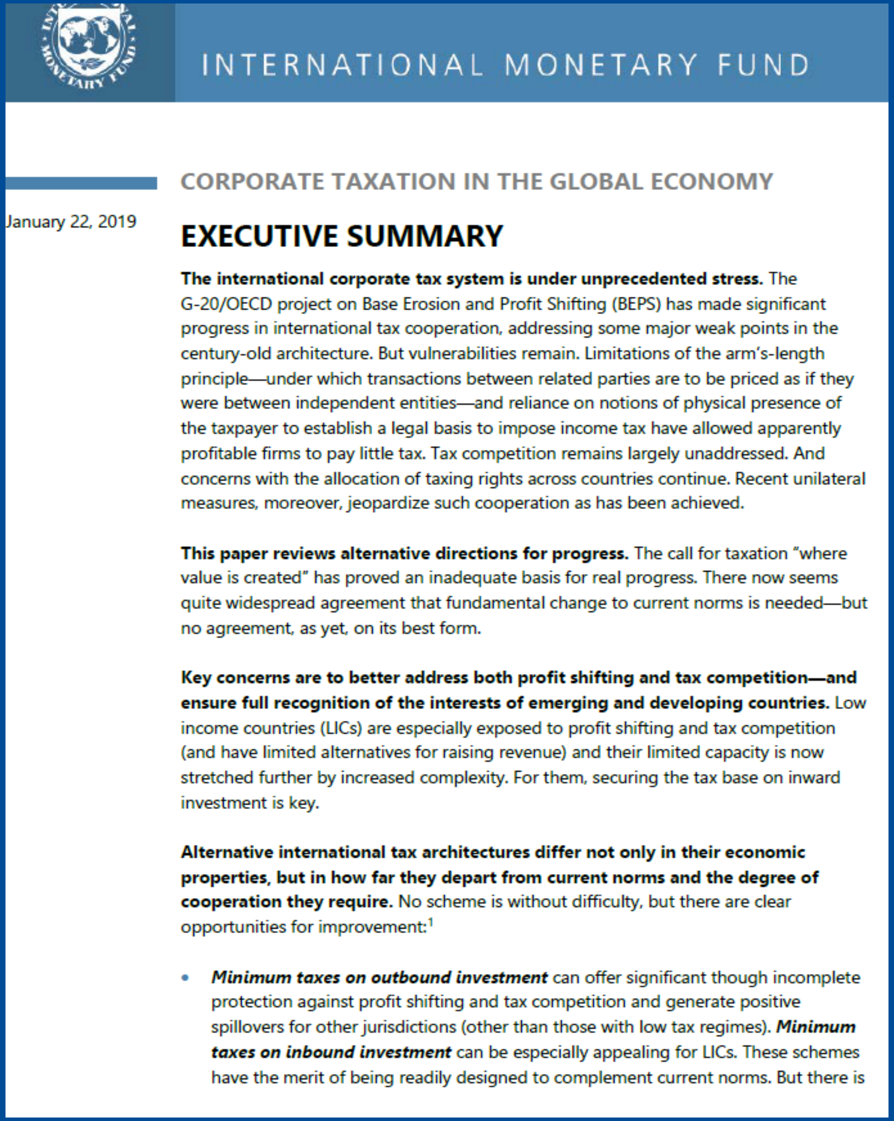

INTERNATIONAL MONETARY FUND

CORPORATE TAXATION IN THE GLOBAL ECONOMY

January 22, 2019

EXECUTIVE SUMMARY

The international corporate tax system is under unprecedented stress. The G-20/OECD project on Base Erosion and Profit Shifting (BEPS) has made significant progress in international tax cooperation, addressing some major weak points in the century-old architecture. But vulnerabilities remain. Limitations of the arm's-length principle—under which transactions between related parties are to be priced as if they were between independent entities—and reliance on notions of physical presence of the taxpayer to establish a legal basis to impose income tax have allowed apparently profitable firms to pay little tax. Tax competition remains largely unaddressed. And concerns with the allocation of taxing rights across countries continue. Recent unilateral measures, moreover, jeopardize such cooperation as has been achieved.

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- ***Minimum taxes on outbound investment*** can offer significant though incomplete protection against profit shifting and tax competition and generate positive spillovers for other jurisdictions (other than those with low tax regimes). ***Minimum taxes on inbound investment*** can be especially appealing for LICs. These schemes have the merit of being readily designed to complement current norms. But there is

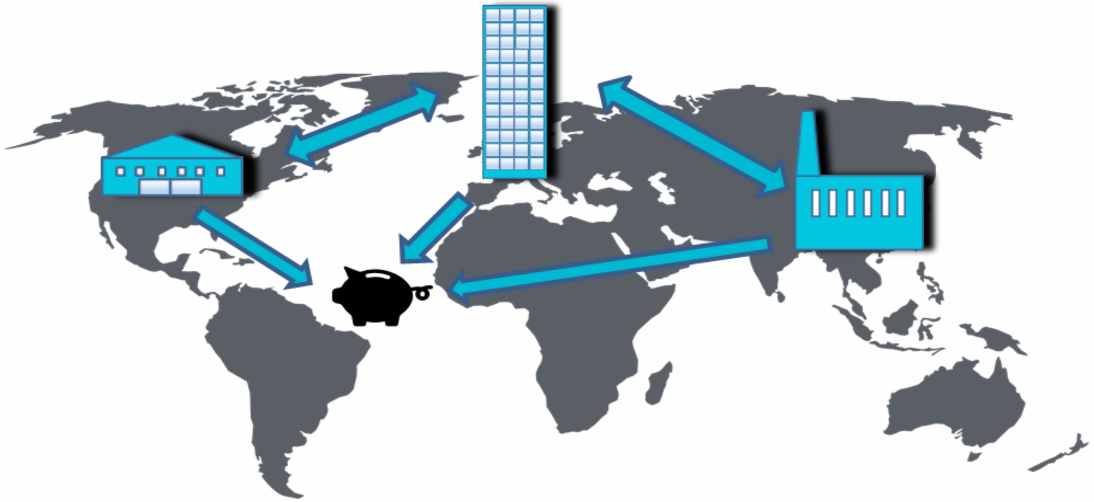
Corporate Taxation in the Global Economy

VIENNA, MAY 22, 2019

Alexander Klemm

Tax Policy Division, Fiscal Affairs Department

The state of the international corporate tax system



Where Things Stand

Multilateral Progress:

- G20/OECD ‘Base Erosion and Profit Shifting’ Project

But unilateral actions, some challenging norms:

- US tax reform, with novel international tax aspects
- Actions/proposals on ‘digital’ taxation

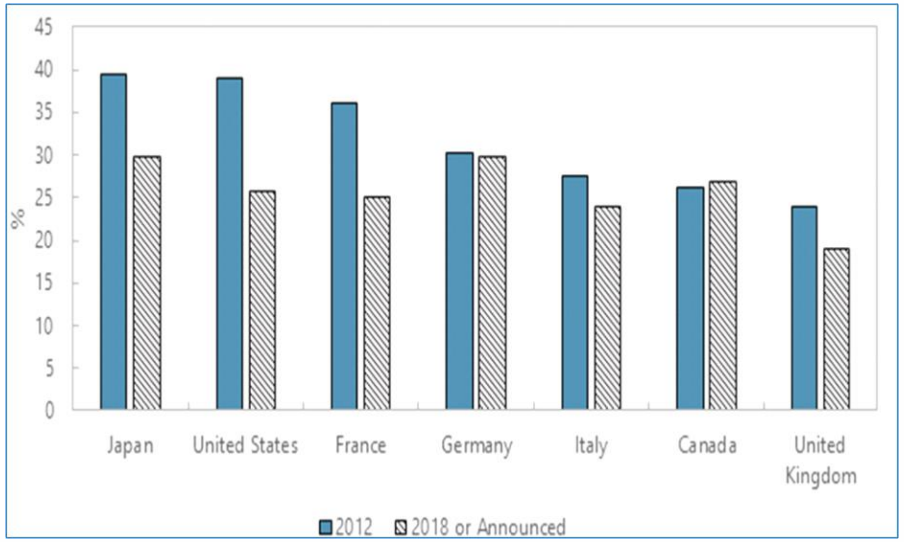
Issue 1: Continued Profit Shifting

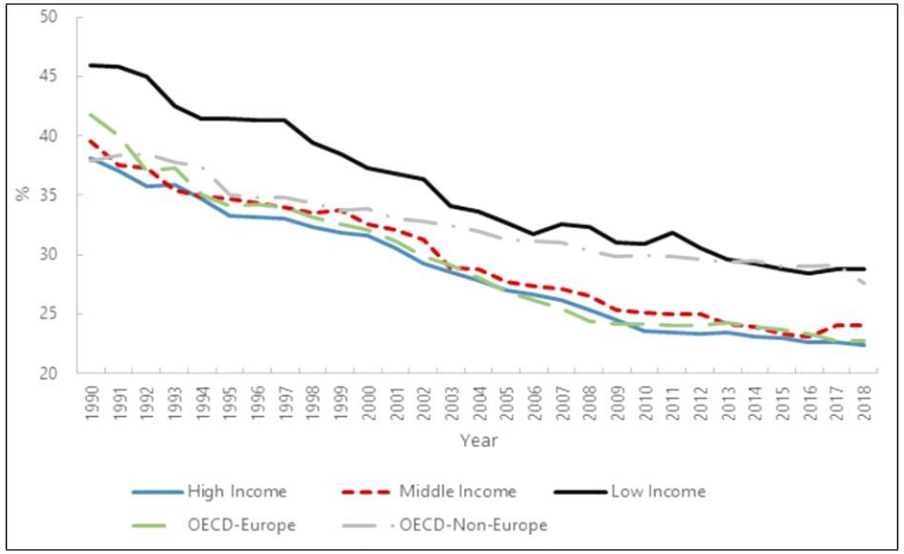
Estimated Revenue Losses from Profit Shifting for the G-7
(in percent of collected CIT Revenue)

	Clausing (2016)	Beer, de Mooij, and Liu (2019)	Tørsløv, Wier, and Zucman (2018)
Year	**2012**	**2015**	**2015**
Canada	…	...	9
France	23	6	21
Germany	28	2	28
Italy	16	-6	19
Japan	18	3	6
U.K.	...	-12	18
U.S.A	26	15	14

- BEPS aimed at some of most egregious devices
- Limitations of arms length pricing
  - E.g., does it make sense to conceive of risk being allocated within an MNE?

Issue 2: Tax Competition

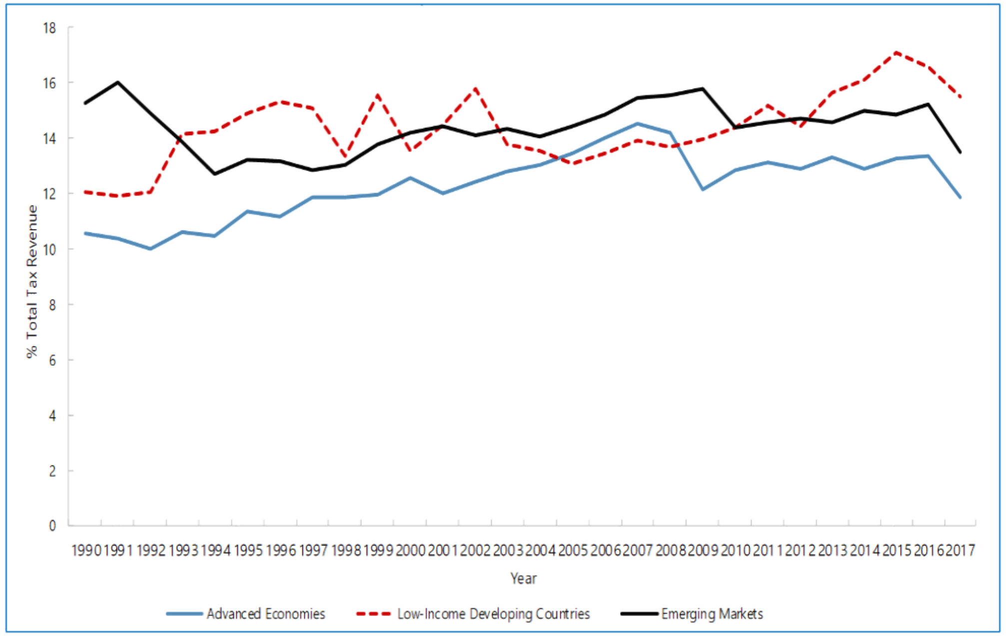




- Good or bad?
- Limiting avoidance may intensify competition for real capital
- Substance tests can lead to wasteful allocation
- Are preferential regimes necessarily harmful?

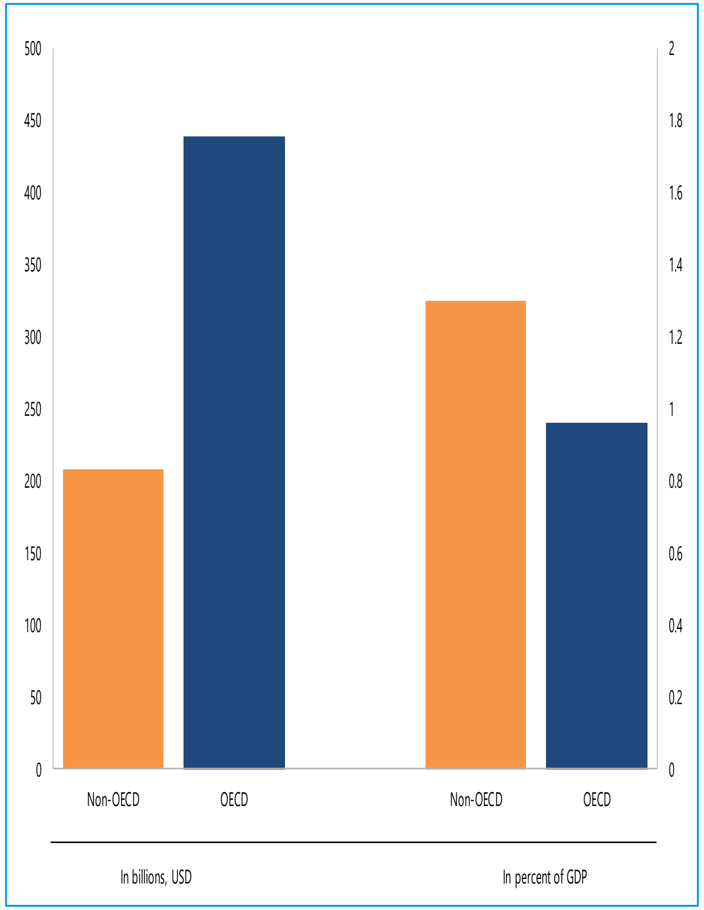
Issue 3: Developing Country Problems

Corporate Income Tax Revenue by WEO Income Group 1990-2017
(Excluding Resource-Rich Countries, in percent of Total Tax Revenue)



- Capacity constraints
- Long-standing concerns in allocation of taxing rights

Estimated Revenue Losses from Profit Shifting in 2013



Source (both charts): IMF (2019)

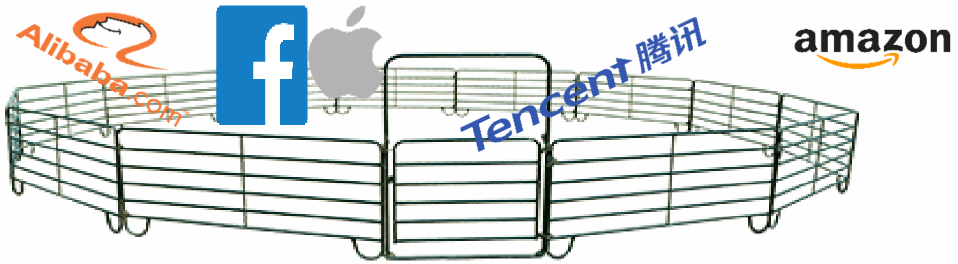
Progress on Issues Stressed in IMF (2014)?

- Double Tax Agreements
  - Multilateral instrument innovative, but partners' agreement still needed
  - Changing PE definition, service fees require renegotiation
- Offshore transfers of interest
  - Platform for Collaboration on Tax (PCT) nearly done!
- Interest deductions
  - Action 4 of BEPS , but problems linger
- Transfer pricing
  - No simpler!

Issue 4: The Digitalization Debate

What's New?

- Business without physical presence—?
- 'User-generated value'—but how distinguish from destination?

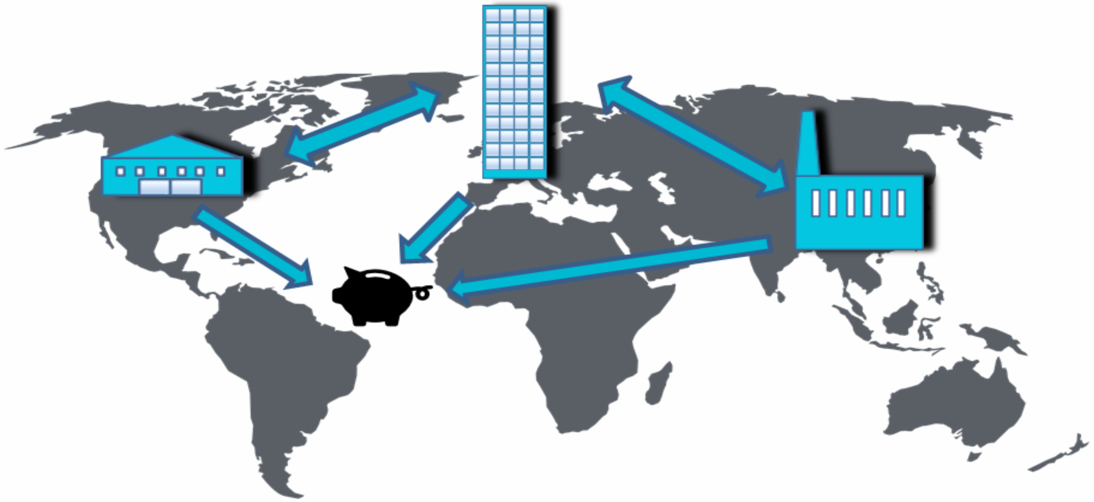


Proposals for:

- 'Digital Services Taxes'
- Long run: 'Significant economic presence' test and share residual profit
- Charges for access to social media (Benin, Tanzania…)
  - What rationale?

Emblematic of limits of "taxing where value is created"

Alternative Architectures



Criteria

No established principles of international taxation

- Except a strong case for taxing rents somewhere

So, pragmatically, look at:

- Vulnerability to profit shifting
- And to [harmful] tax competition
- Ease of administration and compliance
- Legal obstacles
- Suitability for LICs

Impact may differ for common and unilateral adoption

Minimum Taxation

‘Outbound:’ Residence country taxes foreign earnings if tax abroad below some minimum (like GILTI)

- Reduces profit shifting (Across third countries) and tax competition
- which can benefit other countries

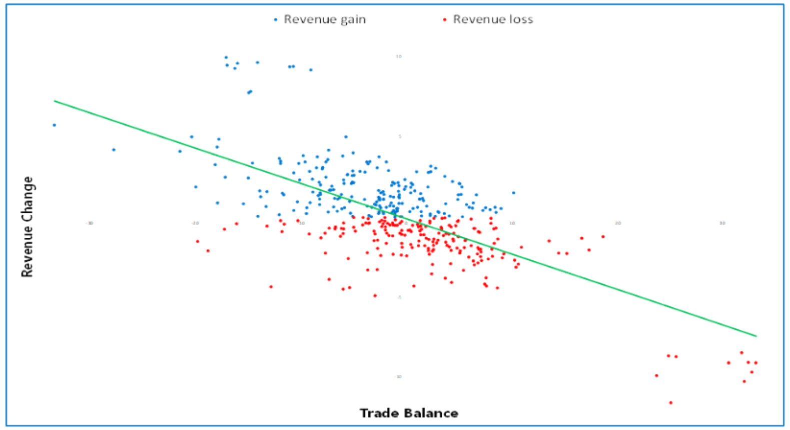
Inbound : Minimum tax on resident affiliates’ to combat base-eroding payments (like BEAT)

- May be especially attractive for LICs
  - Cameroon, Cote d’Ivoire and others have such arrangements
- But can be blunt and increase distortions
  - Is it feasible to test for tax rate paid on other side of the transaction?

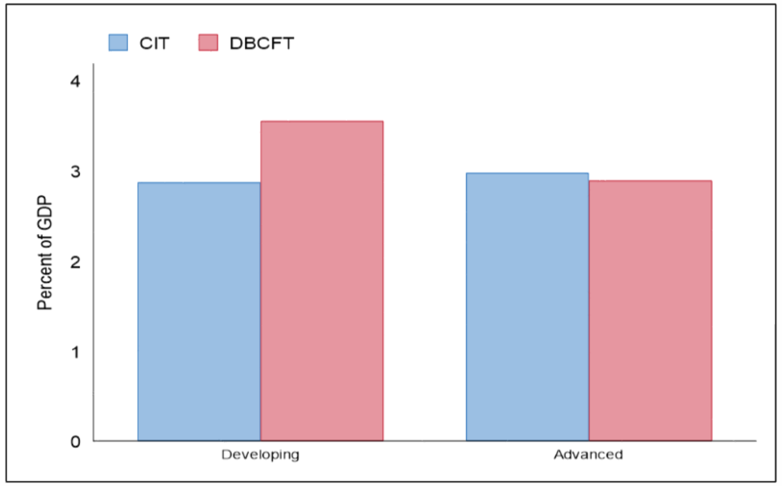
Relatively close to current arrangements/relatively susceptible to unilateral action

Destination-based Cash Flow Tax

Those with trade deficit more likely to gain…



…so too are developing countries:



Source: Hebous, Klemm, and Stausholm (2019)

DBCFT means

- Expensing instead of depreciation
- Exclude exports, include imports

Robust to profit shifting and tax competition

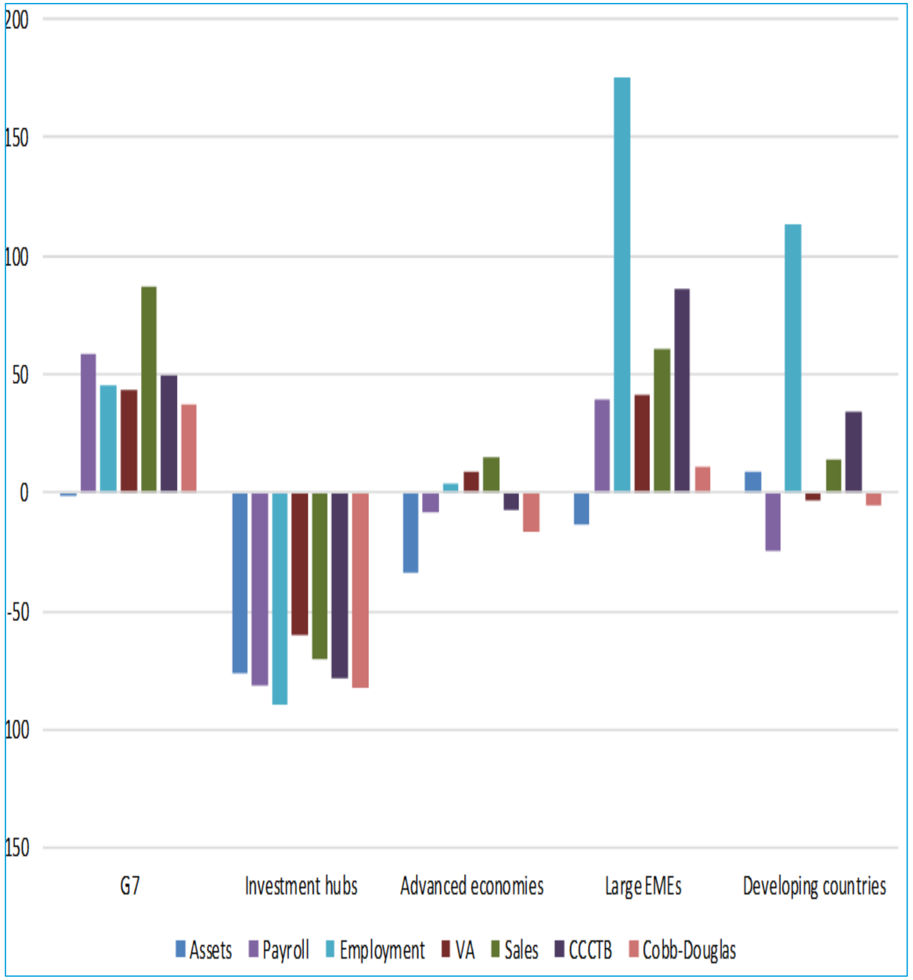
- Falls on rents

For low income countries

- May be less disadvantageous than often thought (assuming resources still taxed at source)

Formula Apportionment

Change in CIT revenue with unitary profit of U.S. MNEs apportioned
(in percent)



Source: IMF (2019)

Advantages

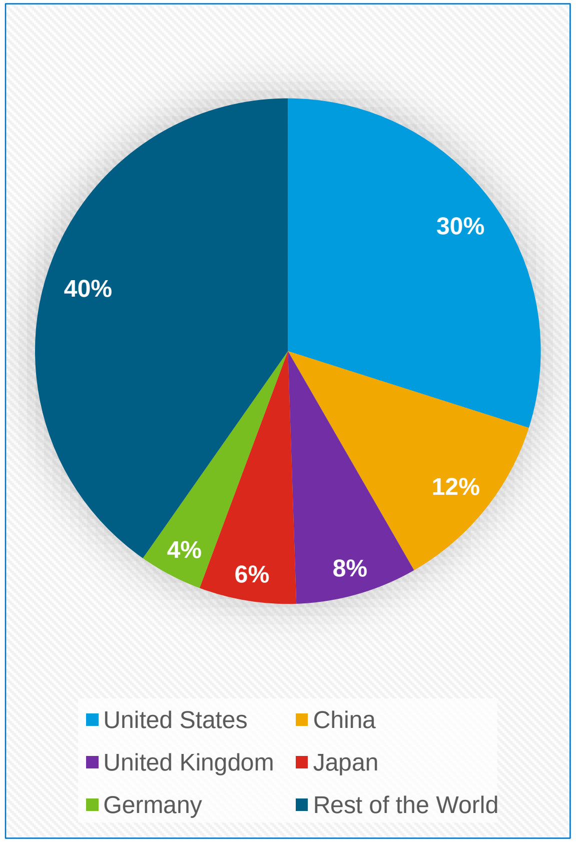
- Eliminates profit shifting

But:

- Much coordination needed
- It all depends on the base
  - Developing countries do not necessarily gain unless high weight on employment

Residual Profit Allocation (RPA)

Share of Global Residual Profit by Country of Headquarters, at Cost Mark-up of 7.5%



Source: IMF (2019)

RPA is a hybrid

- Allocate 'routine' profit by ALP
- Allocate residual by FA

On residual profits:

- Concentrated in firms with US HQs
- As with FA, all depends on the weights

On routine profits:

- Many countries would raise more by fully taxing routine returns than they do now
- But vulnerable to tax competition?

Summary, with Global Adoption

	Protection against:		Ease of implementation:		Suitability to circumstances LICs /1
	Profit Shifting	Tax Competition	Practically	Legally	
Current arrangements					
Digital PE/significant economic presence					
Minimum taxation /2					/3
DBCFT					
FA /5					/4
RPA /6					

Notes:

/1 Source taxation is assumed to continue in the extractive industries.

/2 Minimum tax on both outgoing and inbound investment.

/3 Benefit mainly from inbound minimum.

/4 Gain most sure if apportionment largely by employment.

/5 Assumes apportionment partly by sales, all countries using the same formula; normal return assumed to be taxed.

/6 Robustness greater the more is apportionment by destination-based sales.

Low	Medium Low	Medium	Medium High	High

Governance

Building Tax Cooperation

Multilateralism much needed

Obstacles

- Few, if any, agreed economic principles
- Winners and losers

What model?

- Inclusive Framework an important step forward
  - Fully accommodative views/circumstances of non-G20/OECD?
- Platform for Collaboration on Tax (IMF, OECD, WB, UN)
  - Toolkits
  - Feedback loop from capacity building

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