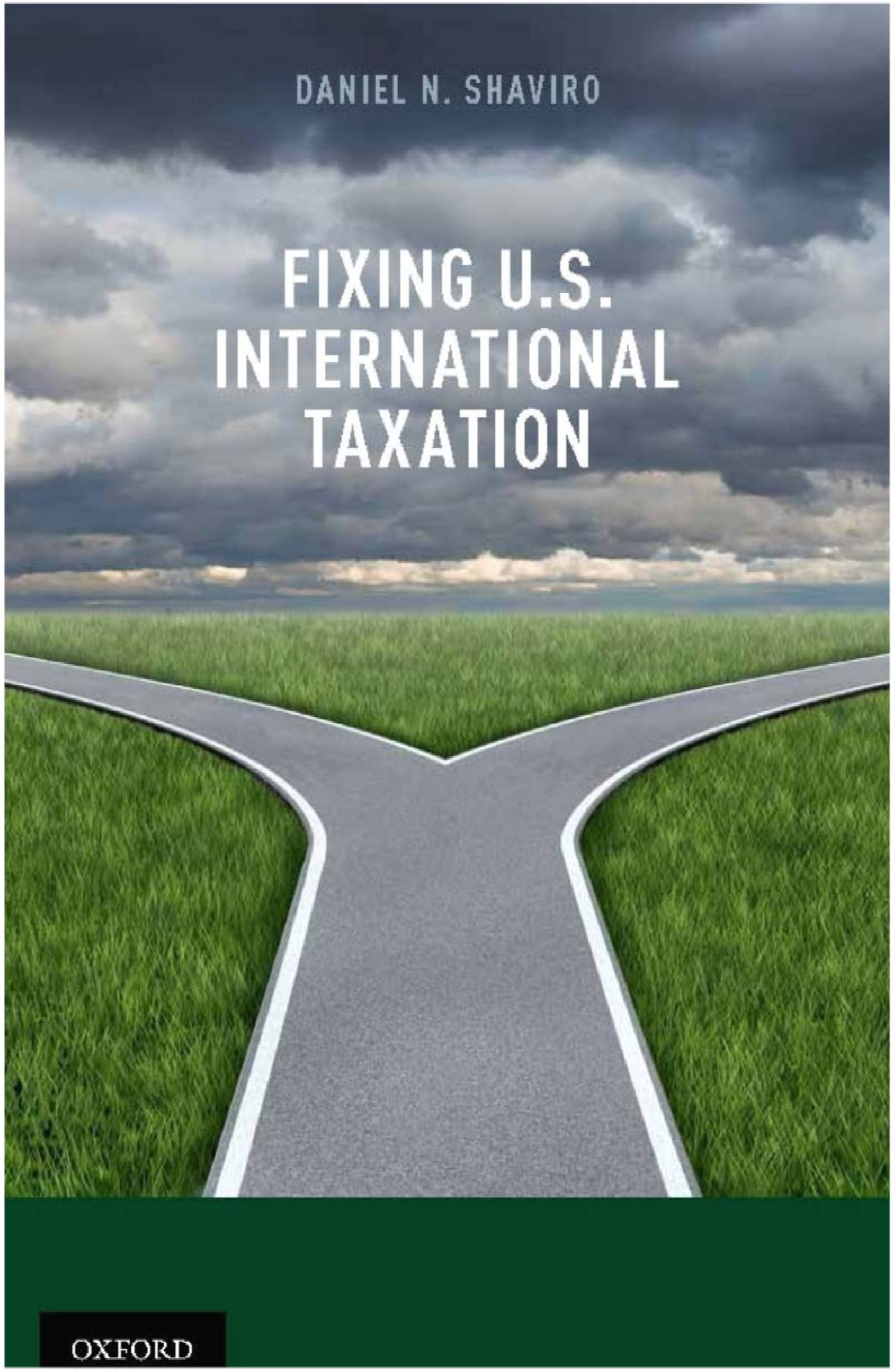


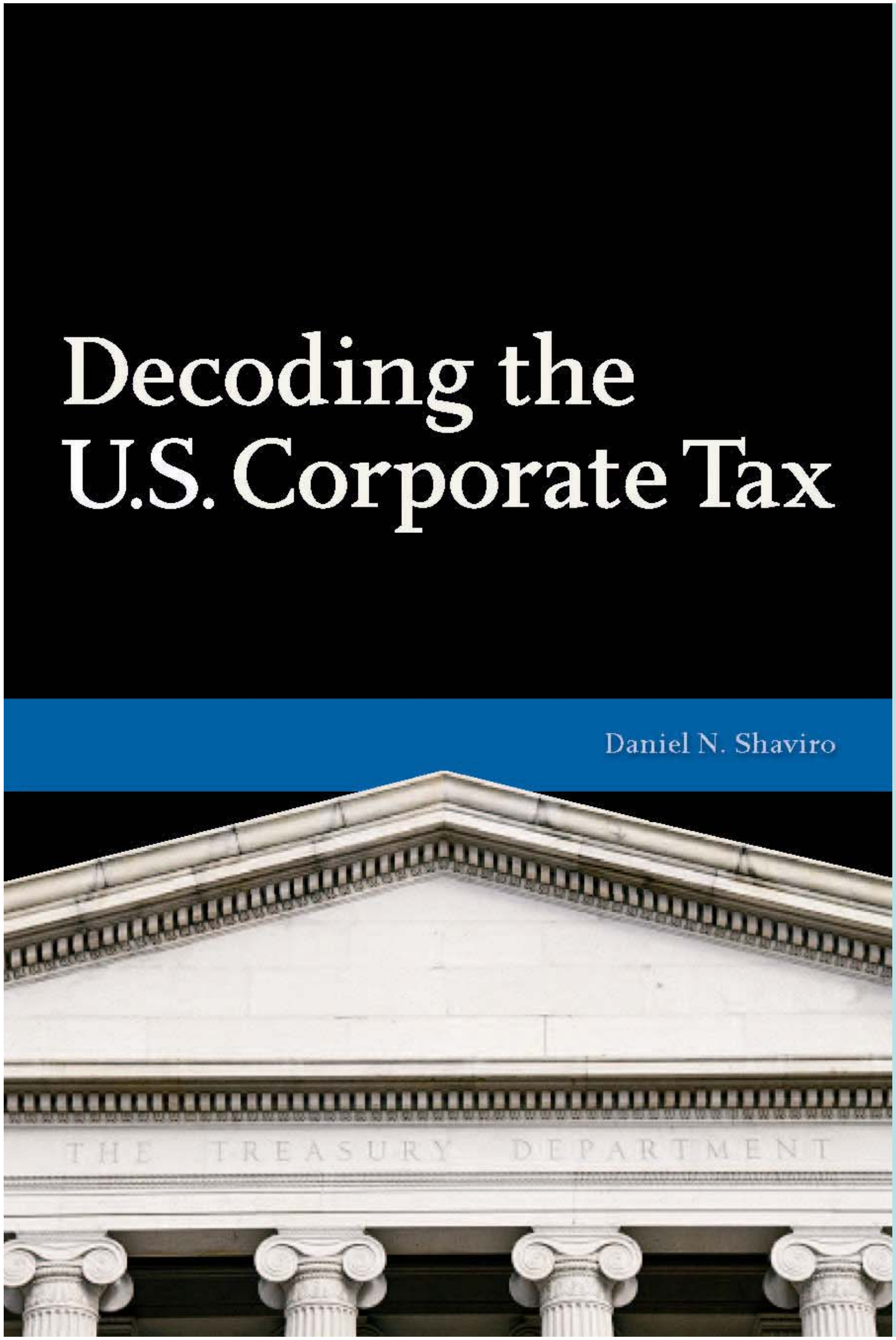
Forthcoming, February 2014

Yogi Berra: “When you come to a fork in the road, take it.”

But in this case the “map” showing a “fork” is not worth the paper it’s (not) printed on.

“Worldwide vs. territorial” is an ill-posed compound choice, not stated in terms of fundamental underlying choices at distinct margins (tax rate on FSI vs. MRR for foreign taxes, more on this shortly).

Neither of these poorly formulated choices leads to a good place.



This 2009 book was the model for *Fixing*, except ...

BIG difference between the corporate tax and international tax literatures.

<u>Corporate tax</u>: “ill-posed problem” inherent to the area; my main aim was just to explain it accessibly.

<u>International tax</u>: Someone once wrote an article aptly titled: “Taxing International Income: Inadequate Principles, Outdated Concepts, and Unsatisfactory Policies.”

Back to Square 1 for finding suitable analytic tools, but luckily other public economics literatures are up to the task.

The nature of the problem

Say the U.S. corporate tax rate is 35%, Germany's is whatever.

U.S. can tax all income earned in the U.S. or by U.S. companies at 35%, but it can't tax income earned in Germany by German companies.

Can't match the U.S. tax rate on U.S. companies' German income to both the domestic rate & the U.S. rate (0%) on German companies' German income.

The usual response: unfounded implicit assumption about global cooperation (misstated & misunderstood by those making it), plus "battle of the neutralities."

Analogy: Say 3 drinks: milk, juice, water. We tax milk, can't tax water, must decide about juice, which may differ from milk in its substitutability with water.

Shouldn't analyze this as a choice between milk-juice neutrality and water-juice neutrality (see instead optimal commodity tax literature).

5 problems with existing frameworks

(1) What is the problem? Is it double (and non) taxation?

(a) Odd discontinuity if, say with 35% U.S. rate & 20% German rate, the U.S. must tax U.S. companies' FSI at a statutory rate of either 0% or 35% (nothing in-between), and with foreign taxes either ignored or fully creditable (nothing in-between).

(b) # of times one is taxed vs. how much one is taxed.

(2) How should we think about foreign taxes? (We don't get the money, limited if any reciprocity since exemption is an implicit deductibility system, tax haven "tagging" issue.)

(3) The issue of multiple margins (a) Average &/or marginal tax rate on FSI; (b) MRR for foreign taxes (& note again that exemption = implicit deductibility). Plus, under the current system, a third margin concerns repatriation disincentives (since new view assumptions don't generally hold).

The "iron box:" consider, e.g., Obama Administration "minimum tax" proposal. Or FTC pooling. Or repealing deferral.

(4) Drowning in alphabet soup (Global welfare fallacy, global convention fallacy. Enough is enough! It's long past time to stop basing analysis on CEN, CIN, CON, NN, NON, etc.)

(5) Lagging conceptual integration between the entity & individual levels. (Entity-level income taxation & cross-border shareholding as the culprits, corporate residence electivity as central to the analysis; note the relevance of SH-level distributional issues.)

5 steps towards a better analysis

(1) Corporate residence: (Choice of definitional attributes should reflect elasticity, externalities if any.)

(2) Source of income: (Not a well-defined concept. Discriminate between types of income? Cheaper vs. costlier sourcing electivity.)

(3) Why tax (or not) "resident" companies' FSI? (Say we could tax *all* FSI of *all* companies. Source-based tax would be unavoidable via investment location & profit-shifting; U.S. individuals would be taxed on all WW income; & we'd get $$ from foreign individuals. But given that this is unfeasible, the question is net benefit from doing this just for what we define as resident companies.)

(4) What's the optimal tax burden on U.S. companies' FSI? (Clearly more than 0%; probably significantly less than that on domestic source income.)

(5) What's the best way to tax FSI? (Broaden the base & lower the rate. Deferral & the FTC both are bad rules, but reduce each other's distortions. Despite this offset, a system with both will have a horrible ratio of DWL to revenue. For foreign taxes, note the tagging issue & tax haven income, to be addressed with express focus on effective MRRs.)