The Crossroads Versus the Seesaw: Getting a "Fix" on Recent International Tax Policy Developments

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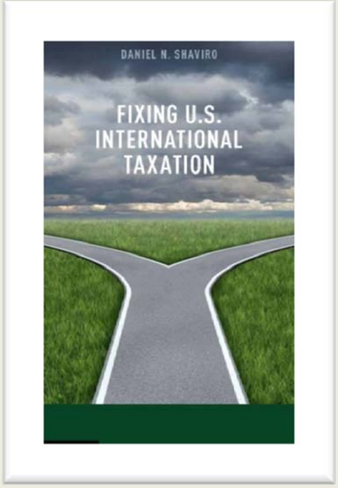
Background for this paper

In *Fixing U.S. International Taxation* (Oxford U. Press, 2014), I aimed to offer fresh ideas for evaluating international tax policy.



I would not object to increasing the speed & breadth of these ideas' dissemination & acceptance.

Plus there have been a # of big developments in international taxation since *Fixing* went final.

What light does *Fixing* shed on analyzing them - & they on it?

Impossible to summarize the paper in 10 minutes – so I won't try (nor will I explain the "crossroads / seesaw" reference in the title).

Fixing, Point 1

Positing a choice between territorial & WW/FTC conflates 2 distinct margins: (1) tax rates (MTR, ATR) on FSI, (2) MRR for foreign tax liabilities.

Taxation of FSI: 0 under pure territorial; same MTR as domestic source (but lower ATR) in a typical WW/FTC system.

MRR for foreign tax liabilities: same as MTR (i.e., 0) in pure territorial (implicit deductibility); 100% in a typical WW/FTC system (ignoring deferral & FTC limits!).

Why must the two margins be linked? And why not consider allowing intermediate values for each?

Fixing, Point 2

Countries w/ some market power over corporate residence but less than that re. domestic investment, generally should tax FSI (overall) at > 0, but < domestic source income.

In terms of ATRs but not MTRs, this is already near-universal.

WW systems provide FTCs & deferral; territorial systems tax "bad" FSI (generally that which is either observed or expected to be in tax havens).

In both types of systems, can target "bad" FSI via CFC rules. Or can reach FSI indirectly (without targeting the "bad") via thin capitalization rules.

How choose between these two types of approaches?

CFC rules trade off the virtue of getting to target "bad" FSI against the vice of their only applying to resident companies.

Fixing, Point 3

MRR for foreign taxes should possibly / sometimes be > MTR for associated FSI, but always < 100%.

From a unilateral domestic standpoint, foreign taxes are just a cost, suggesting that the MRR should = the MTR for FSI.

This makes TPs indifferent between foreign tax liabilities & all else.

But if tax haven location is a tag for "bad" domestic profit-stripping, may want anti-tax haven rules despite effectively raising the MRR.

A 100% MRR, whether resulting from FTCs or anti-tax haven rules, would eliminate all foreign tax cost-consciousness.

[Point 4: deferral, in non-new view setting, lowers the tax burden on FSI **& the MRR**. Thus, if repealing/changing it, consider interactions.]

Recent developments

Again, the paper seeks to engage with new developments in light of *Fixing*'s analysis (& vice versa).

It addresses 5 in particular:

(1) New-wave U.S. inversions,
(2) OECD-BEPS Action Plan,
(3) UK's diverted profits tax (aka "Google tax"),
(4) Patent box proposals,
(5) Recent U.S. international tax reform proposals (Camp, Baucus Staff, Obama Administration).

I'll probably have more to say than the current draft offers before publication. But in any event, today I'll just address #1 and #5.

Recent development #1: new-wave U.S. inversions

These are actual deals, rather than paper-shuffling self-inversions.

Key motivations include easing access to offshore “trapped earnings,” avoiding U.S. CFC rules that impeded profit-shifting out of the U.S.

They reflect the *beta* (potential change in U.S. tax burdens), not the *alpha* (such burdens’ absolute level).

German tax directors often claim they face greater tax burdens than their U.S. compatriots (e.g., due to tougher thin capitalization rules) – so why aren’t they comparably expatriating?

It just wouldn’t help, part 1: deferral induces “leaving town” (like skipping out on a loan).

It just wouldn’t help, part 2: thin cap rules, unlike CFC rules, would still apply.

What do we learn from inversions?

Tougher anti-inversion rules, including those that would require new legislation, make sense as a stopgap.

But standing alone, this is just "Put a stronger lock on the barn door before all the horses get out."

More generally, since it's about the beta not the alpha, two key lessons are as follows:

(1) Whatever we ultimately do about deferral – which affects both the FSI burden & MRR margins – need to clear the decks a bit! E.g., mandatory deemed repatriations even if *don't* go territorial.

(2) In taxing FSI (insofar as we do), may need to rely *less* on CFC rules & more on residence-neutral approaches (thin cap, UK Google tax, etc.).

Recent development #5: U.S. international tax reform proposals

I'll focus today just on Baucus Staff Discussion Draft, option Z.

This would "split the baby" between WW/FTC and exemption. E.g., say 60-40, while the U.S. corporate rate is still 35%.

Then the U.S. MTR for FSI would be 21%, & the MRR 60% - within *Fixing*'s broad parameters, & probably treaty-compatible. (No "double tax" if one can bifurcate.)

E.g., it's like §911(d)(6) (no FTC for excluded earned income) & the 2004 dividend holiday's denial of FTCs for the deductible % of repatriations.

Treaty compatibility seems clear if MRR ≥ (FSI tax rate / domestic tax rate) – but this equation's terms may be ambiguous.

Summing up

Important to keep in mind how poorly framed the supposed choice between "WW" & "territorial" really is.

Significant overlaps in practice. Plus, the supposed choice conflates 2 distinct margins: tax burden on FSI, MRR for foreign taxes.

In practice, we may want to de-link the 2 margins, allow intermediate values for each. (0 < **tax rate on FSI** < full domestic rate; MTR < **MRR** < 100%.)

New wave inversions suggest some urgency in addressing the U.S. rules – but re. marginal incentives to expatriate in particular.

The "splitting the baby" approach that I described in Shaviro (2014) is far more likely to be treaty-compatible than I realized at the time.