The Two Faces of the Single Tax Principle

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A single tax principle?

Treaties arguably say "tax everything once" if we broaden the "fiscal evasion" concept.

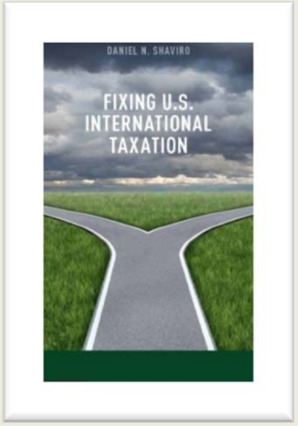
Terminology: double taxation departs from this principle on the "upside;" double non-taxation and stateless income depart on the downside.

But the two "faces" raise distinct issues, not all that usefully amalgamated.

Upside departures are a bit of a red herring – treaties that ban it (if they do!) may impede good solutions.

Downside departures may be problematic, but raise more complicated issues – & hard to address effectively through bilateral tax treaties.

Upside departures



# of times taxed is formalistic! What matters is tax burdens imposed.

E.g., I'd rather be taxed 20X @ 1% each time than once @ 35%.

Say U.S. has 35% rate, Germany 20%, Acme-US earns $100 pre-tax in Germany.

Classical WW/FTC (worldwide/foreign tax credit) system: Acme-US pays $15 U.S. tax.

Suppose instead that the U.S. only allows foreign tax deductions, but taxes FSI (foreign source income) @ 15%.

Acme now double-taxed, but pays only $12! So it's a victimless "crime."

Why this matters

Two distinct margins: domestic tax burden on FSI, MRR (marginal reimbursement rate) for foreign taxes.

WW/FTC and territoriality are compound systems – for no good reason, once one rejects the upside of the single tax principle.

WW/FTC: MTR (marginal tax rate0 for FSI = domestic rate (too high), ATR (average tax rate) depends on domestic vs. foreign tax rates (anomalous), MRR = 100% absent deferral (too high).

Deferral lowers ATR & MRR, but guarantees a bad ratio of DWL (deadweight loss) to revenue.

Territoriality: MTR & ATR for FSI = 0% (too low), MRR = MTR (implicit deductibility) which is either just right or too low (note universality of CFC rules addressing stateless or tax haven income).

A better way?

Baucus Staff Discussion Draft, Option Z, shows how broadening the options might be treaty-compatible.

Say each dollar of FSI is 60% taxable with FTCs, 40% exempt.

Then, with a 35% tax rate for domestic source income, MTR = 21%, MRR = 60%.

While no reason to think this is perfect, probably better than what we have today (if also no deferral, raise or lower the 60% ratio as one likes).

I'd argue that this is (or should be) treaty-compatible – no double taxation in form if one allows bifurcation.

More importantly, in substance it addresses over-burdening FSI to the same degree as requiring that the ratio be 0% or 100%!

An unwise retreat?? (Or not)

Do we need a simple and powerful norm (such as anti-double taxation) to discourage over-burdening FSI?

Maybe “Yes” if countries were strongly inclined to over-burden FSI – but there is little evidence of this.

The widespread shift towards territoriality, rationalized on national self-interest grounds, sheds light on this question.

What’s more, allowing bifurcation really does not weaken any such protection as the anti-double tax norm provides.

Requiring that the MRR be ≥ FSI tax rate / domestic tax rate directly addresses over-burdening.

Downside departures

Being taxed zero times – unlike being "taxed twice" – actually *does* tell us something about the burden imposed.

0 times any finite number = 0!

But need further analysis to see why & when this might be objectionable.

The people in a given country don't directly benefit from paying taxes to *another* country – so the downside isn't directly / unilaterally / unconditionally objectionable.

Reasons for objecting to double/global non-taxation: (a) tag for domestic base-stripping?, (b) reciprocity / cooperation.

Addressing downside departures

Treaties aren't a promising mechanism, since they're bilateral & responses may need to be multilateral.

OECD-BEPS (obviously) addresses that, though how successfully remains to be seen.

Arranging multilateral cooperation is difficult!

Anti-OECD-BEPS political winds already swirling in the U.S. (not a surprise).

Even with widespread adoption, the retention of separate entity accounting, transfer pricing, etc., might invite pessimism.