

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.

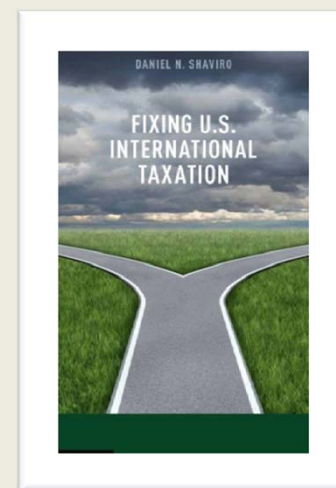
What light does *Fixing* shed on analyzing them - & they on it?

Down to the crossroads

U.S. proponents of a switch to territoriality often claim the U.S. is at a “crossroads,” demanding immediate action.

OK, fair enough to admit that I, too, have stuck my toe in these fetid metaphorical waters.

Three points that these proponents often ignore:



(1) The “worldwide vs. territorial” distinction is greatly overdrawn – in practice, substantial overlap between systems bearing the 2 labels.

(2) The distinction conflates & oversimplifies the available choice set (more on this shortly).

(3) Re. the putatively territorial countries: “If everyone else has gotten it right ... why aren’t they happy?”

Alternative metaphor: the seesaw

OECD countries were fine for a while with multinational companies' (MNCs') international tax planning, but then it went "too far."

Hence, recent pushback such as the OECD BEPS project, with the aim of restoring proper balance by some metric.

E.g., "single tax principle": make sure everything is taxed exactly once.

Fixing deals harshly with the single tax principle, which is formalistic & demands a Hobson's choice between WW/FTC and territorial systems.

But today I'll find something to like about the single tax principle.

Overview for the rest: 4 main points in *Fixing*, 4 recent developments.

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 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.

For resident MNCs, “bad” FSI can be reached via CFC rules. For foreign MNCs, indirectly via thin capitalization rules.

Why use CFC rules, which discourage using resident companies?

The countervailing advantage is better targeting of “bad” FSI (if tax haven income is disfavored for “tagging” reasons).

Fixing, Point 3

MRR for foreign taxes should be $>$ MTR for associated FSI, but $<$ 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, anti-tax haven rules may make sense even though they effectively raise the MRR.

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

Fixing, Point 4

Under non-new view conditions (e.g., lack of a fixed repatriation tax rate), deferral reduces both the ATR for FSI & the MRR for foreign taxes.

Bad through deferral is, need to keep in mind its interactions with the ATR & MRR.

E.g., going pure WW not only raises the ATR, but makes the MRR truly 100%.

This is a big problem for “minimum tax” proposals, which effectively repeal deferral up to a point.

If repeal deferral by going (more) territorial, why not impose a transition tax re. the past earnings?

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

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

3 main U.S. tax motivations: easier access to offshore “trapped earnings,” avoid U.S. CFC rules that impeded profit-shifting out of the U.S., avoid US CFC rules that pertain to “actual” FSI.

A false talking point: “Inversions show how harshly the U.S. rules treat resident MNCs.”

But: inversions reflect the beta, not the alpha – the resulting change in U.S. tax burdens (including DWL from deferral), not their absolute level.

U.S. vs. Germany: MNC tax directors in both countries claim to have it worse. But German MNCs can't avoid thin cap by expatriating.

U.S. could address “loan balances” (via deemed repatriations, not holidays).

Recent development #2: OECD/BEPS Action Plan

Not within *Fixing's* main focus: multilateral, deep in the muck of source rule details.

But consider Action 2, aimed at “hybrid mismatch arrangements.”

This reflects the single tax principle, but in a good way.

Double non-taxation via semantic arbitrage, like that from using tax havens, may be a tag for profit-shifting at the expense of the domestic tax base.

Hence, addressing it even unilaterally may make sense, improving the prospects for multilateral coordination.

Recent development #3: U.K. diverted profits (“Google”) tax

Large MNCs may be taxed @ 25% (vs. 20% regular corporate rate) on “contrived arrangements” (avoiding PE rules, aggressive transfer pricing).

Has been criticized on multiple grounds beyond my scope here (e.g., vagueness, treaty compatibility, jumping the gun on BEPS, UK’s “open-for-business” self-presentation).

One clear potential advantage, however, is that (like thin cap rules) it can address profit-shifting by non-resident MNCs.

The tax rate disparity may also serve to backstop transfer pricing enforcement.

Recent development #4: U.S. international tax reform proposals

3 serious recent entries: Camp, Baucus, Obama Admin's 2016 budget.

Camp: 95% dividend exemption, rules addressing "bad" FSI. A serious effort, included transition tax, but otherwise not especially novel.

Baucus, option Z: CFC rules would "split the baby" between WW/FTC & 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.

Obama Admin's 2016 budget: 19% minimum tax, but effectively just an 85% FTC (addressing the MRR problem); transition tax.

Summing up

How tax FSI (which all countries do!): CFC rules discourage residence (which is bad) but permit tagging (which may be good); other approaches, such as thin cap, may do neither.

U.S. new wave inversions: show perils of relative over-reliance on the CFC aspect; need to address deferral “loan balances” (but via deemed repatriations, not holidays).

Single tax principle: bad to limit options & conflate the FSI tax rate / MRR margins; but may make sense to focus on “untaxed” income (from tax havens, hybrids/semantic arbitrage).

Fixing approach of taxing FSI at > 0 , with $MRR < 100\%$ & no deferral, is more feasible than I thought at the time.