

Taxing multinationals

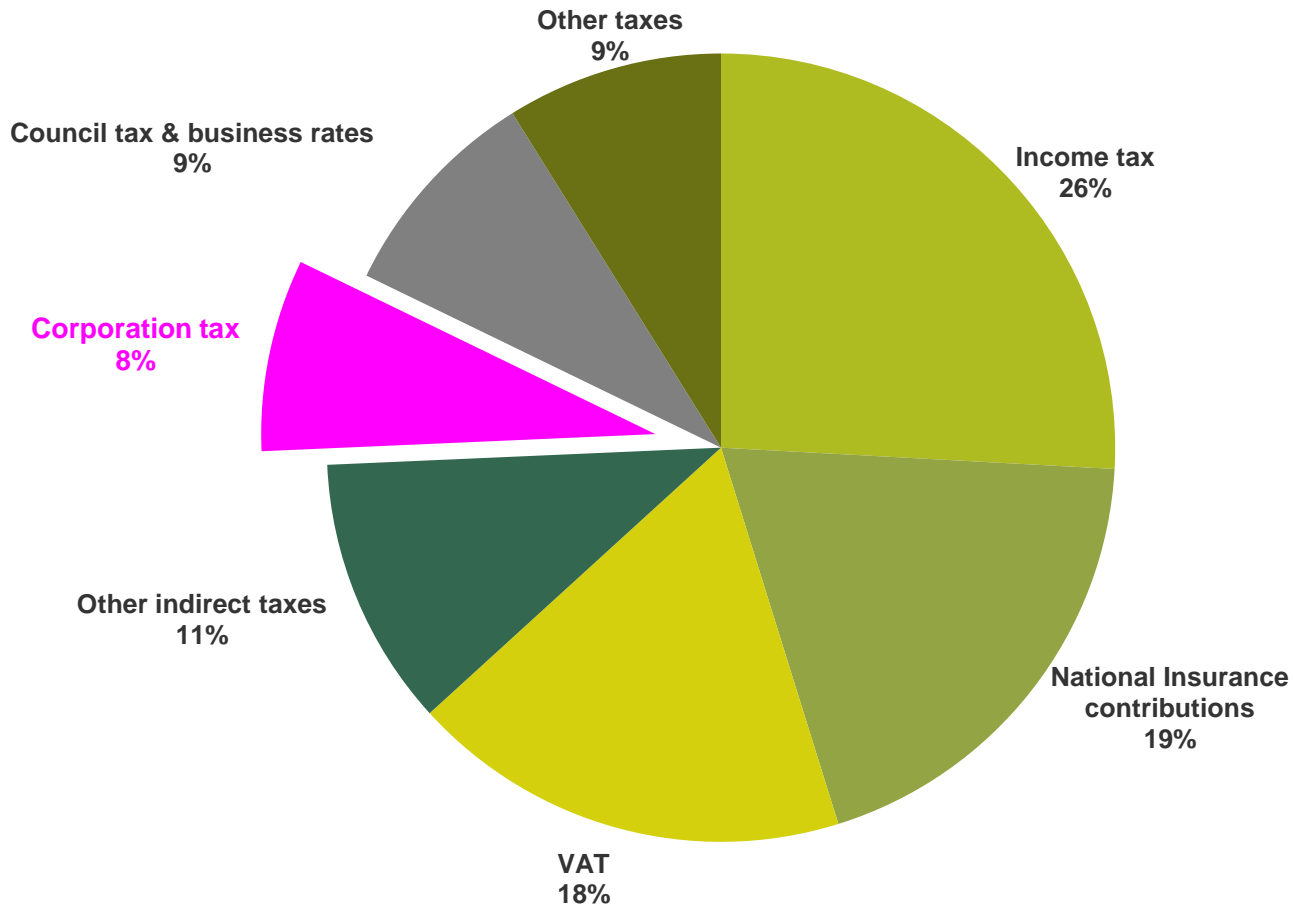
Presentation to Society of Professional Economists

Helen Miller, IFS Deputy Director

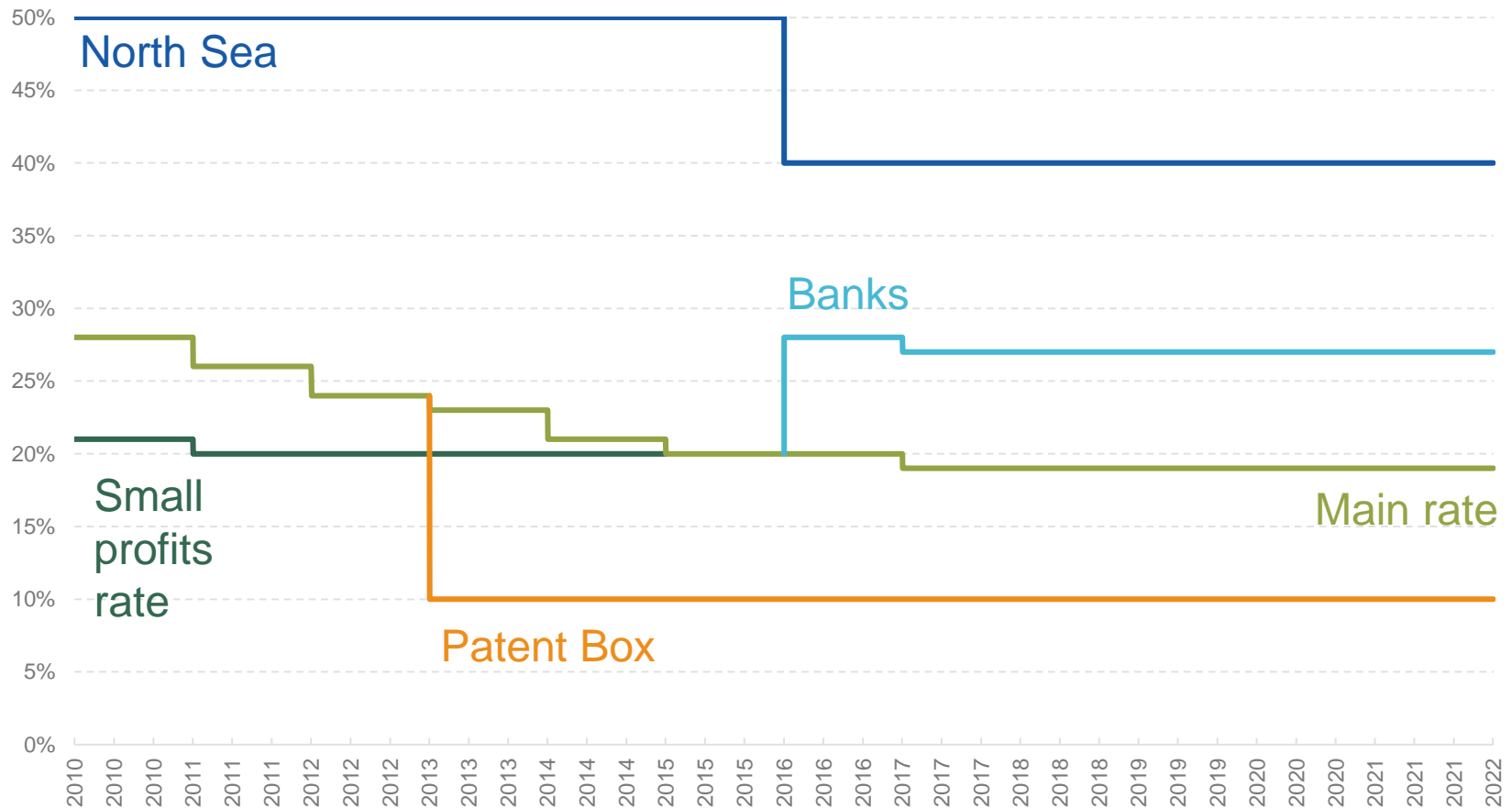
Plan for today

1. **Some facts and key issues on corporate tax**
2. **How are we trying to tax multinationals?**
3. **Options for fixing the taxation of multinationals**

Corporation tax brings in 8% of total UK revenue



Main rate has been cut And more rates have been introduced



Have also been changes in the base

Base is important

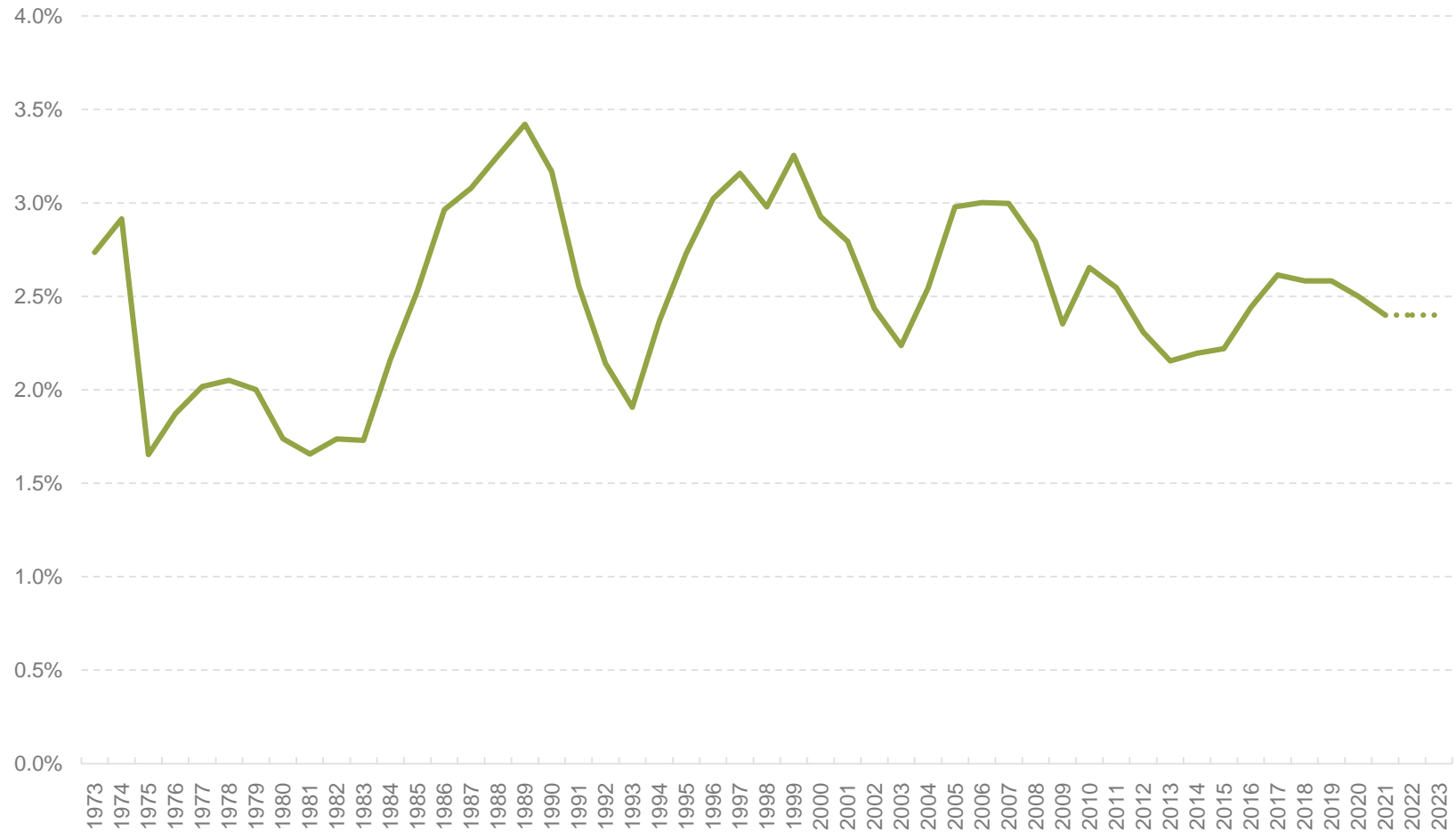
- has problems (e.g. debt bias)
- less generous capital allowances than other countries

Have been changes in the base – affect revenues

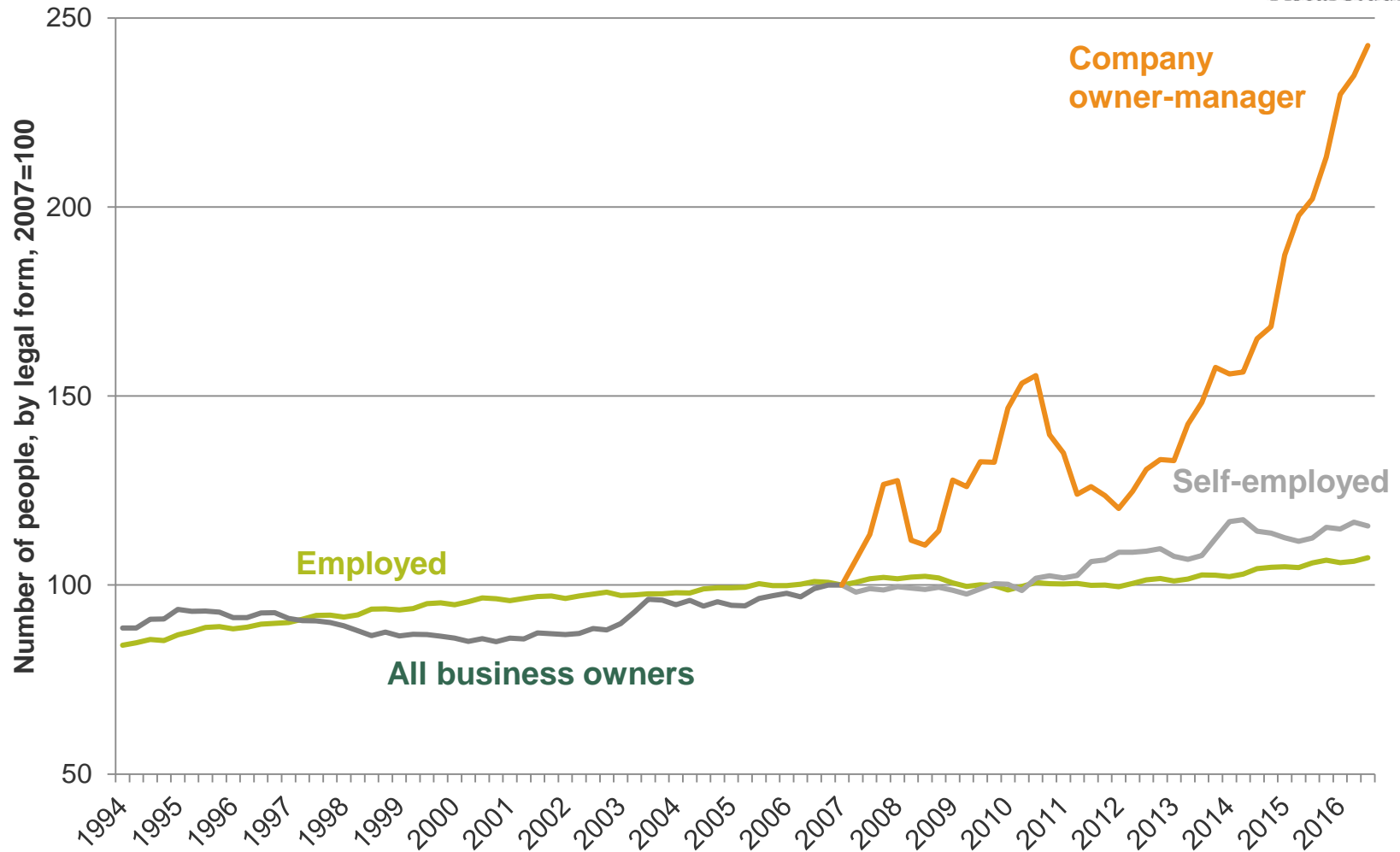
- capital allowances
- restrictions on interest deductibility
- loss offsets

Revenues are volatile

Onshore revenue as share of GDP



Rapid rise in single director companies



How do we tax multinationals?

Starbucks pays £18.3m tax but £348m in dividends

Company has faced years of criticism for the amount of tax it pays in UK



One Direction paid more UK tax than Facebook

Luke Graham, special to CNBC.com
Friday, 13 Nov 2015 | 9:15 AM ET



Financial reports filed by One Direction reveal the pop band paid more corporation tax in the U.K. than social media giant Facebook.



One Direction: £8.2 million in corporation tax

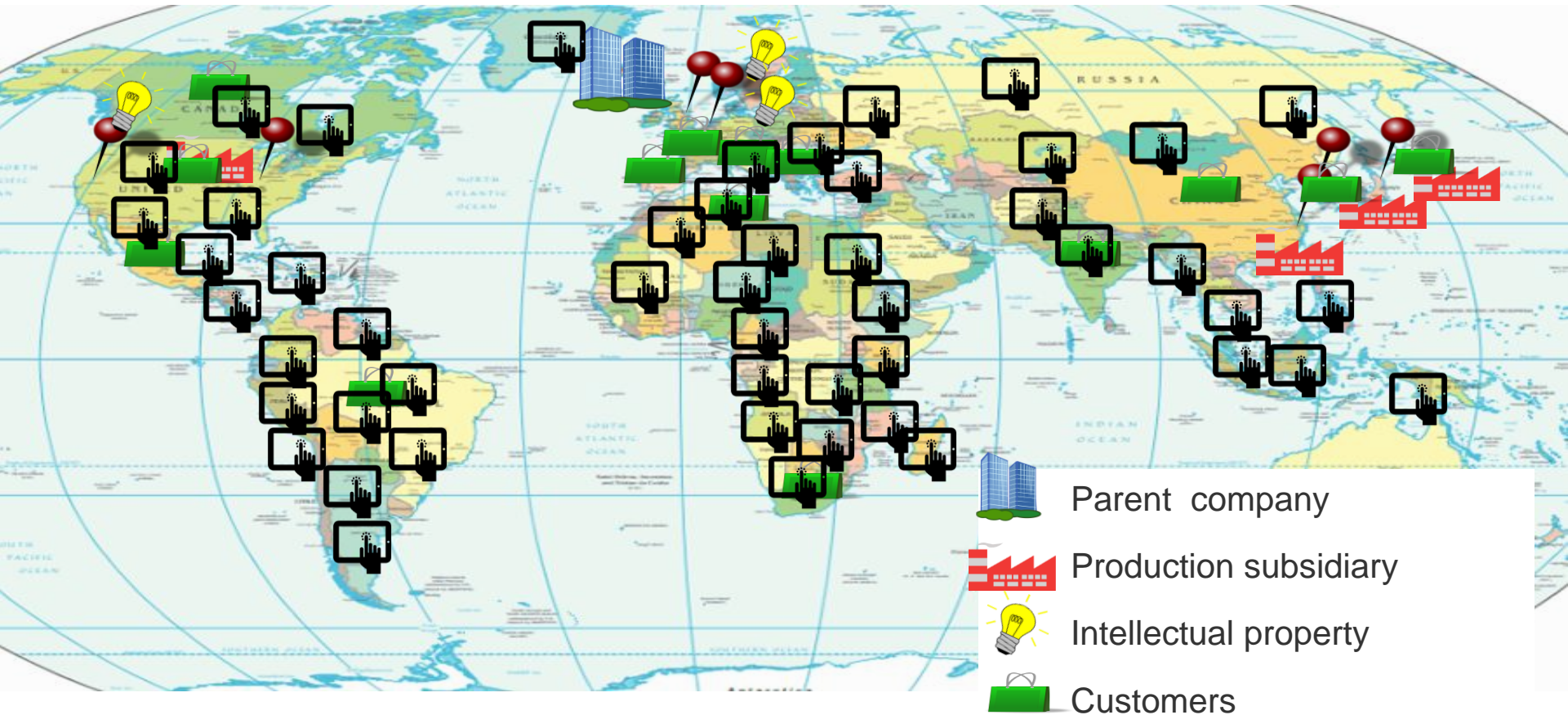
Facebook: £4,327 in corporation tax

Google shifted \$23bn to tax haven Bermuda in 2017, filing shows

Firm used Dutch shell company in move known as 'double Irish, Dutch sandwich' that cuts its foreign tax bill



Allocation of corporate tax receipts is hard



Recap: why is taxing multinationals hard

Multinationals operate in many countries & we have to decide how to allocate tax revenues to different countries

- Activities in different countries are related and complementary
 - United Nations estimates that around 80% of global trade is linked to multinationals' production networks.
- It is hard even conceptually to decide where value is created – room for disagreement
- Firms have more information about their activities

Activities have become harder to allocate across tax jurisdictions

- More integrated global supply chains
- More hard to value and easy to move intangible assets

Recap: problems with how we tax multinationals

System is based on allocating profits (broadly) to ‘source’

- Not even a right way to do this in principle
- In practice, use the Arm’s Length Principle – imperfect & open to manipulation
- Distorts location choices & can reduce investment in a country
- Doesn’t match public expectations

Firms can manipulate mismatches between systems to gain a tax advantage

- Moving intangible assets
- Lending from low tax countries to high tax (so interest deducted at high rate)
- Manipulating transfer prices

Governments have an incentive to compete

- And they do

Examples of profit shifting using debt

Example 1: Intra-group loans

Consider a multinational company with two subsidiaries, subsidiary A in a country with a tax rate of 10% and subsidiary B in a country with a tax rate of 20%. Subsidiary A makes a loan to subsidiary B of £100 million at an interest rate of 10%. The interest on the loan is £10 million, which is deducted from subsidiary B's taxable profit and added to subsidiary A's taxable profit. Assuming subsidiary B has other profits against which to offset this payment, tax payable by subsidiary B decreases by £2 million (20% of £10 million) while tax payable by subsidiary A increases by £1 million (10% of £10 million). Overall, therefore, the intra-group loan has reduced the tax liability of the multinational group by £1 million.

Example 2: Location of third-party interest expense

Now consider an investment made by subsidiary A of £100 million with a return of 20%. If subsidiary A takes out a third-party loan of £100 million at an interest rate of 10%, the pre-tax profit of the investment will be £10 million and the post-tax profit will be £9 million.

If, on the other hand, subsidiary B takes out the same loan and provides £100 million in cash to subsidiary A (an untaxed equity purchase), pre-tax profit of subsidiary A will be £20 million and the pre-tax loss in subsidiary B will be £10 million. Assuming subsidiary B can offset this loss against other profits, the post-tax loss is £8 million, while the post-tax profit for subsidiary A is £18 million. The total pre-tax profit is £10 million and the total post-tax profit is also £10 million. By locating interest in the higher-tax country, the multinational has ensured that the investment is not taxed at all.

From: www.ifs.org.uk/uploads/gb/gb2016/gb2016ch8.pdf

Options for fixing how we tax multinationals

Options

1. Keep trying to patch up the current system

- Measures in individual countries – but tension with desire to stay competitive
- Large projects by the OECD to foster coordination
 - Base Erosion and Profit Shifting (BEPS) completed Oct 2015
 - Pillar 1 & 2 initiatives underway

OECD BEPS

2 year multilateral attempt to improve the international tax system

- involved over 100 countries,
- completed Oct 15 with 15 actions
 - changes that all countries have agreed to enact (eg transfer prices)
 - recommended changes that governments can choose to follow

UK actions post BEPS

- **Country by country reporting** will help countries target resources
 - But it won't mean avoidance can always be identified
- Changes to the definition of **taxable presence** in tax treaties
 - While it 'moves the goalposts' the incentive to cheat it remains
- UK to implement '**anti-hybrid**' rule from 2017
 - recommended best practice but won't be implemented everywhere
- **Patent boxes** to be modified to be more closely linked to real activity
 - The patent box remains a poorly targeted innovation policy

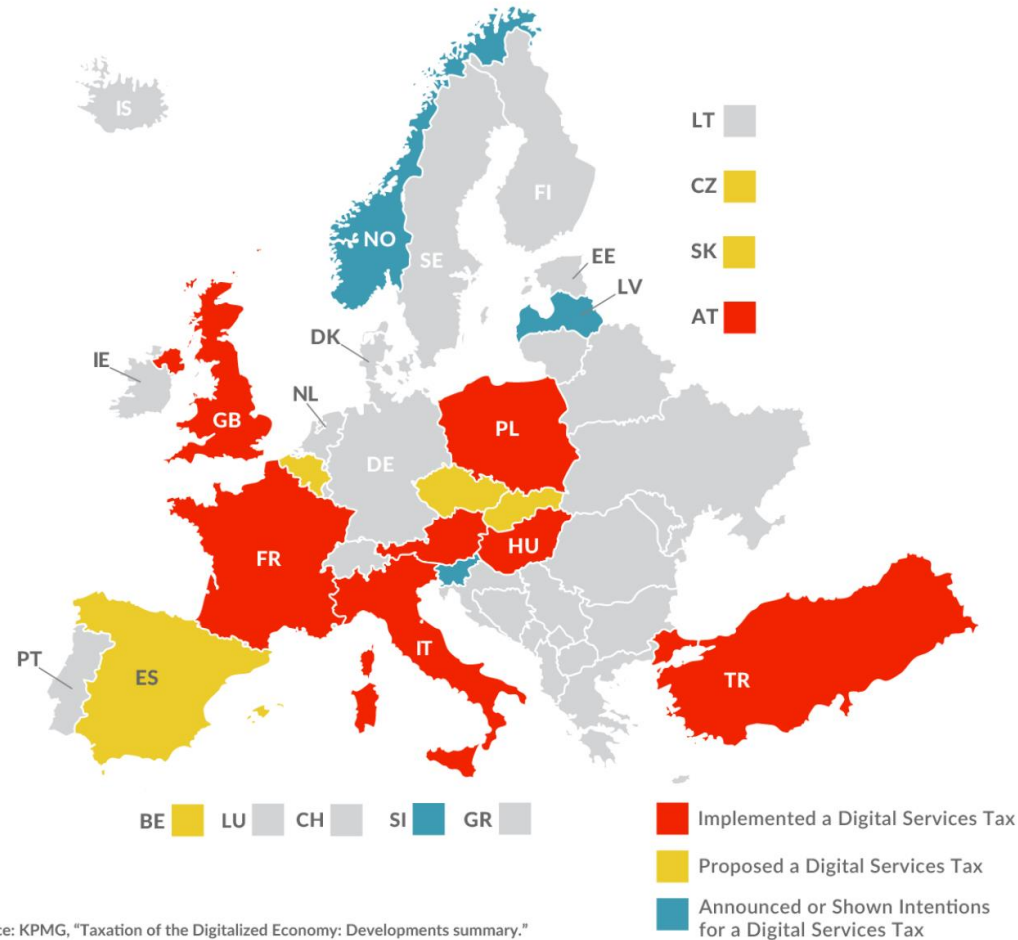
What's happening now

Many European countries are introducing digital services taxes

- UK from April 2020. 2% on worldwide revenues of search engines, social media platforms & online marketplaces if > £25m of revenues derived from UK users
- Turnover taxes are problematic - disadvantage high cost, high revenue business models
- Small measure in revenue terms - £400m
- Would be removed in international consensus reached on alternative approach

Lots of digital services taxes – all different

Announced, Proposed, and Implemented Digital Services Taxes in Europe, as of June 22, 2020



Source: KPMG, "Taxation of the Digitalized Economy: Developments summary."

From: <https://taxfoundation.org/digital-tax-europe-2020/>

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OECD: Pillar 1 – how to tax the digital economy

- Action 1 of BEPS led to specific proposals with the aim of allocating taxing rights on 'residual profits' based on the location of users/consumers

OECD: Pillar 2 - global anti-base erosion (GloBE)

- Effectively a minimum tax as a backstop to other measures

Requires international agreement

- US has suspended talks & is threatening retaliation

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2. Redesign the system from scratch

- Plenty of options to choose from – most also have problems

Could allocate profits based on any factors or using a formula... 'fairness' not a good guide



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2. Redesign the system from scratch

- Plenty of options to choose from – most also have problems
- Global coordination is difficult & unlikely
- Could pick an option that could be introduced unilaterally

Destination Based Cash Flow Tax

Destination basis

- based on sales of goods & services in the country less expenses incurred in the country
 - imports are taxed; receipts from exports are not ('border adjustment')
- key idea: customers are least mobile factor

Benefits

- No distortion to investment location & no tax competition if all countries have
- neutral treatment of debt and equity as sources of finance
- robust against avoidance through inter-company transactions
- resistant to tax competition
- can be implemented unilaterally (would be an aggressive move)

Bold move, & practical issues to deal with, but a large prize

(http://www.etpf.org/files/Devereux_ETPF_policy_paper_2017.pdf)W

