## SOME CURRENT ISSUES IN CORPORATE TAXATION



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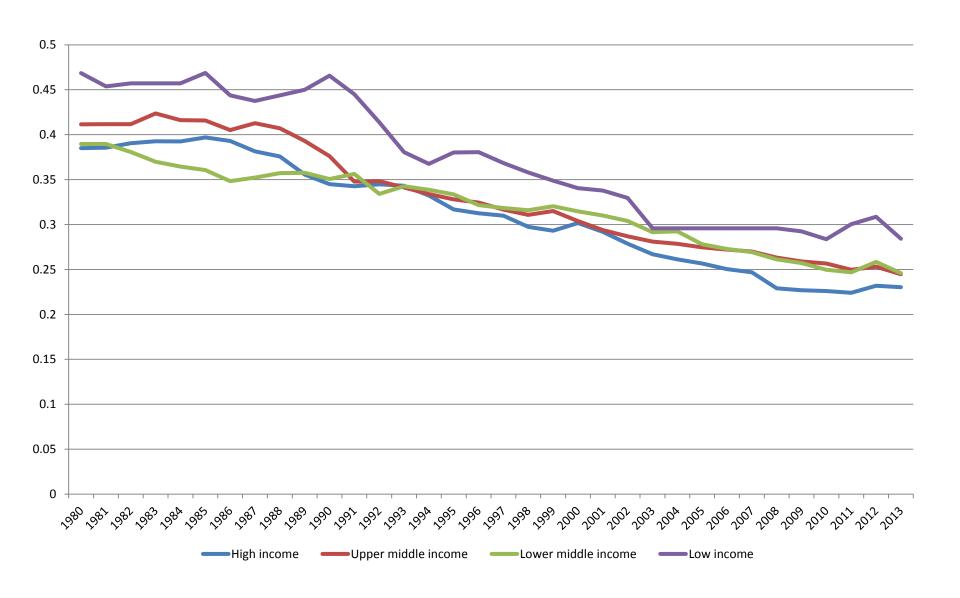
#### Overview

Trends—in rates and revenues

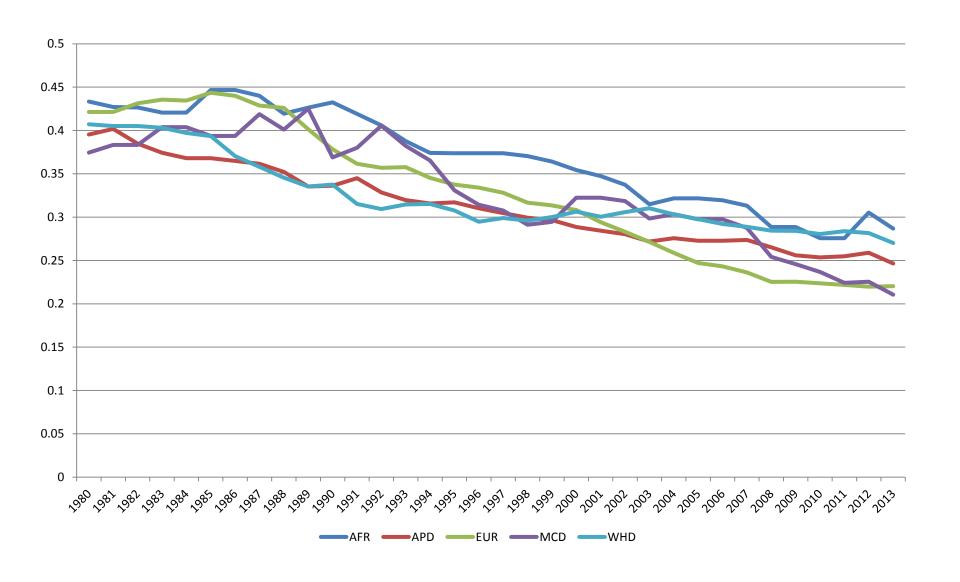
- Selected current issues
  - Interest deductions
  - Tax competition
  - Alternatives to the current international architecture?

# TRENDS—IN RATES AND REVENUES

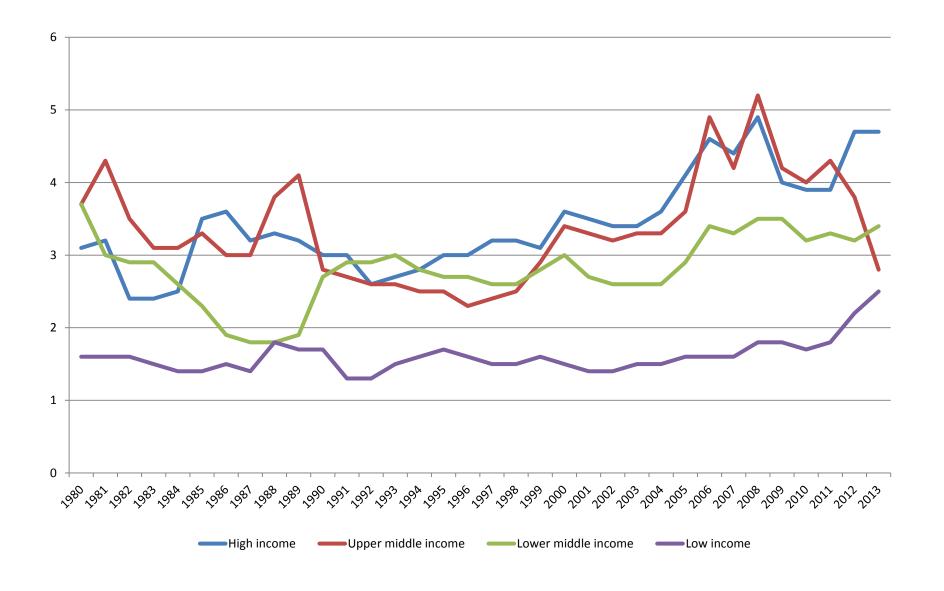
## Statutory rates, by income group...



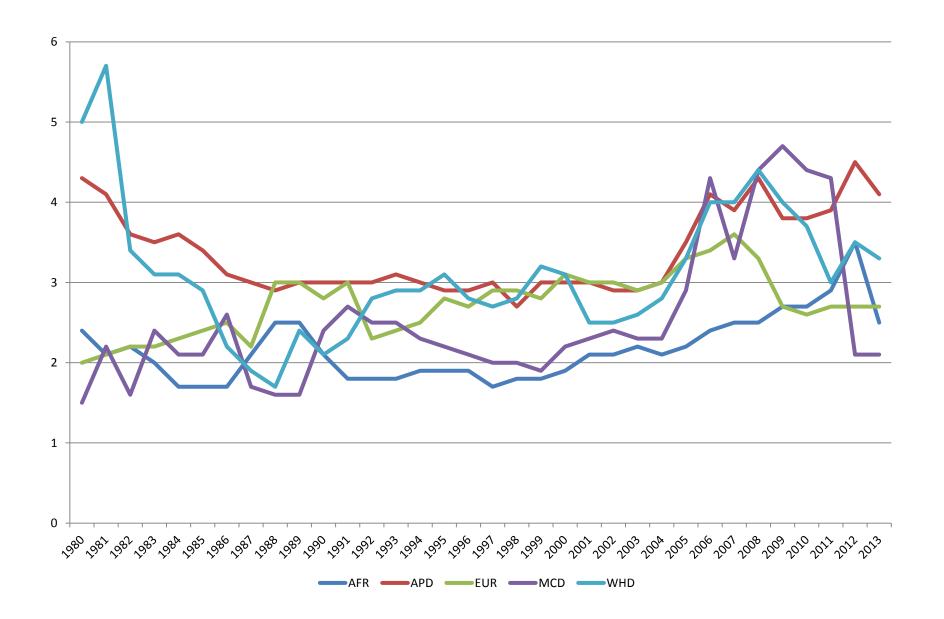
## ....and by region



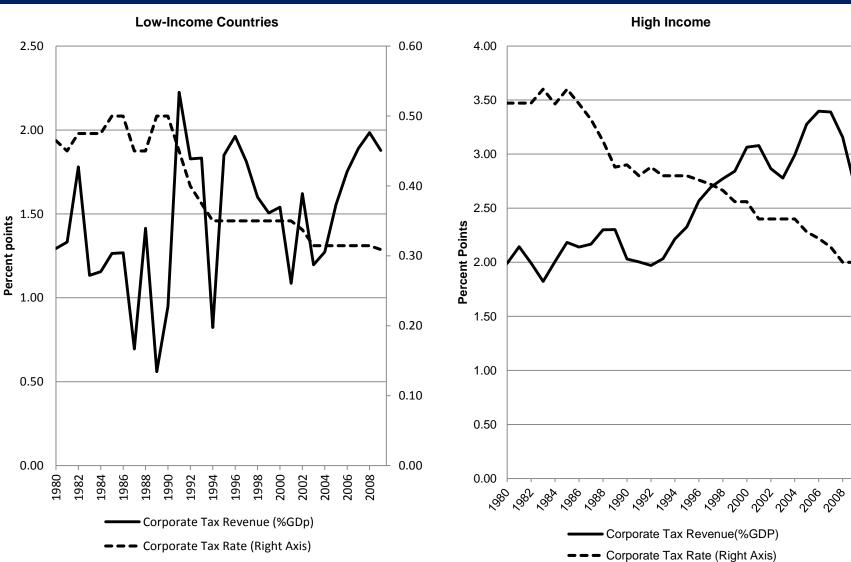
### Revenues/GDP, by income group...



## ...and by region



#### Striking pictures



0.50

0.45

0.40

0.35

0.30

0.25

0.20

0.15

0.10

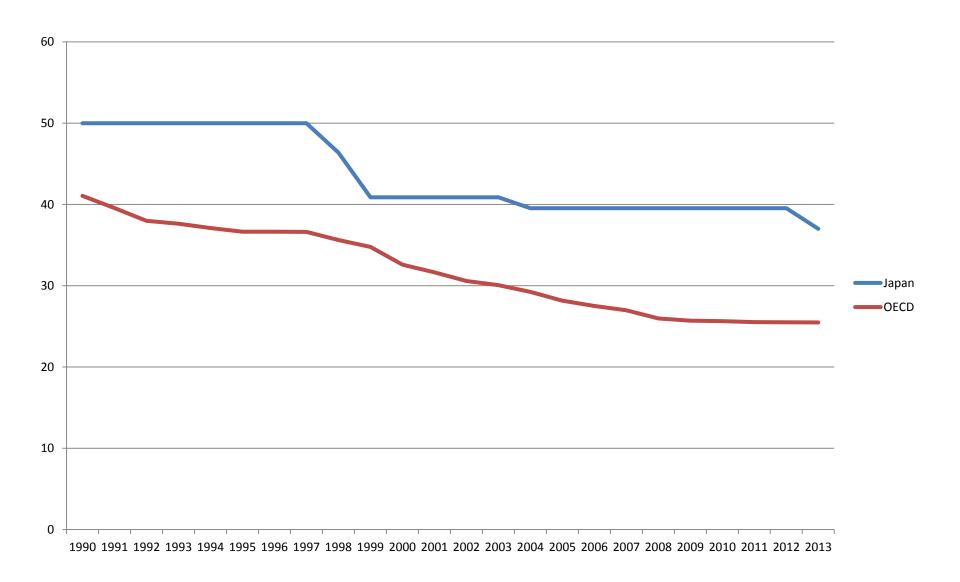
0.05

0.00

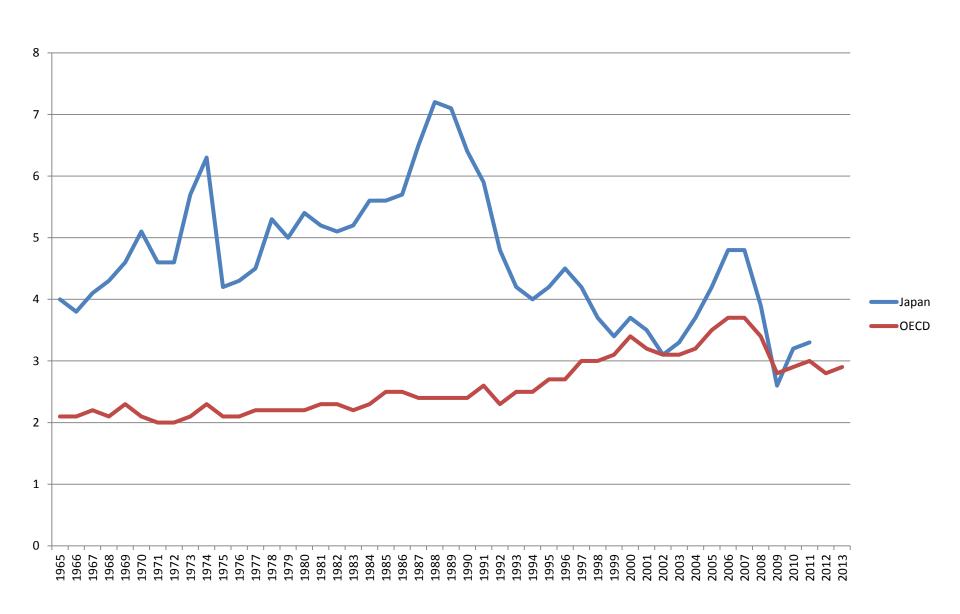
#### How have revenues held up?

- Base broadening?
  - Not the full story
- Importance of financial sector profits
  - At least until crisis
- Increased share of profits in GDP
- Stronger tax incentives to incorporate?
- Laffer effects?
  - Return to later...

## For Japan: The rate....



#### ...and revenues



#### Laffer effects?

- Always tempting—and some have put in low 30s
- But empirical evidence on revenue maximizing
   CIT rates contentious
  - Kawano and Slemrod (2012)
  - Likely to depend e.g. on others' tax rates
  - And e.g. to be higher in larger countries
- For a large country like Japan, response of others' a real consideration

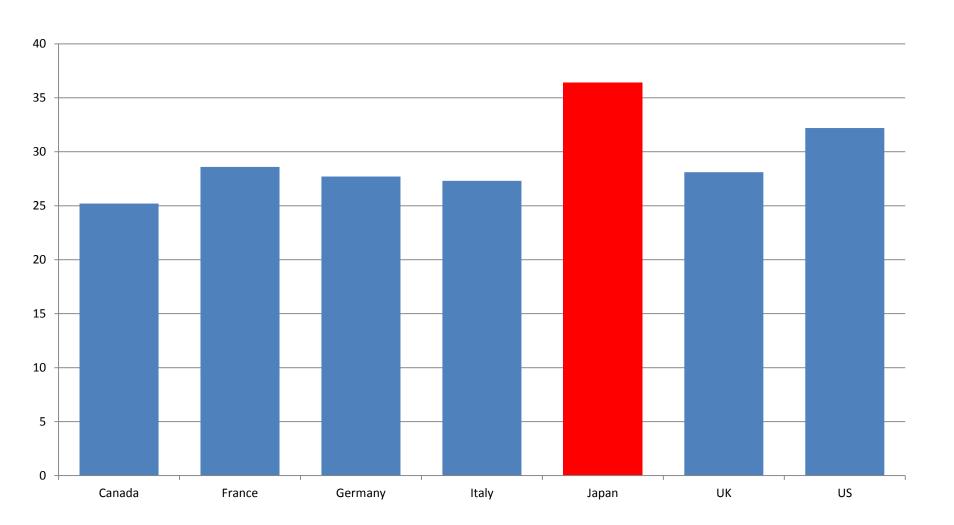
#### It isn't just the headline rate that matters

- Profit shifting incentives depend on statutory rate
  - relative to others, and on international tax rules

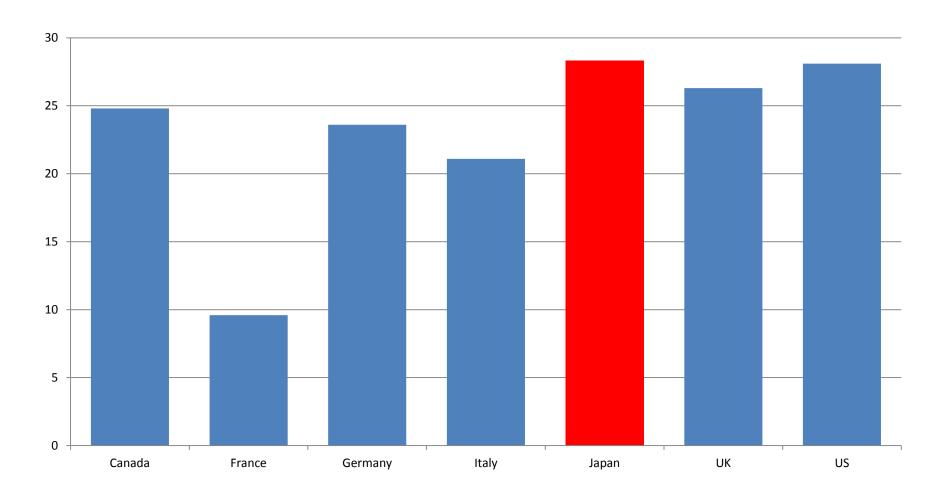
But also need to consider:

## Discrete location choices depend on average effective tax rate (AETR)

—on an intra-marginal project



- Investment given location depends on marginal effective tax rate (METR)
  - Excess of pre-tax over required post-tax return



#### Growth effects of the CIT?

- CIT commonly at bottom of 'hierarchies' of growth friendliness
  - Though less clear in lower income countries

- But effect must depend on form of coproate tax
  - A rent tax has METR =0 and so should not discourage investment

#### **SELECTED CURRENT ISSUES**

### Treatment of interest

#### Two distinct issues

Interest deduction as a profit shifting device

Tax preference for debt over equity finance:
 'Debt bias'

#### Interest and profit shifting

- A straightforward device: Shift (apparent) risk by lending from low tax jurisdiction to high
  - As many times as possible ('double dips')

- Increased attention in last few years
  - Addressing this is BEPS Action Item 4
- Why allow any deduction for related party loans?
- More limited responses:

#### Possible/actual responses differ widely

- Nature of limit
  - 'Thin cap'
  - 'Earnings stripping
  - Use only ALP
- Carry forward?
- Related party only?
  - If so, cannot address debt bias

#### Dealing with debt bias

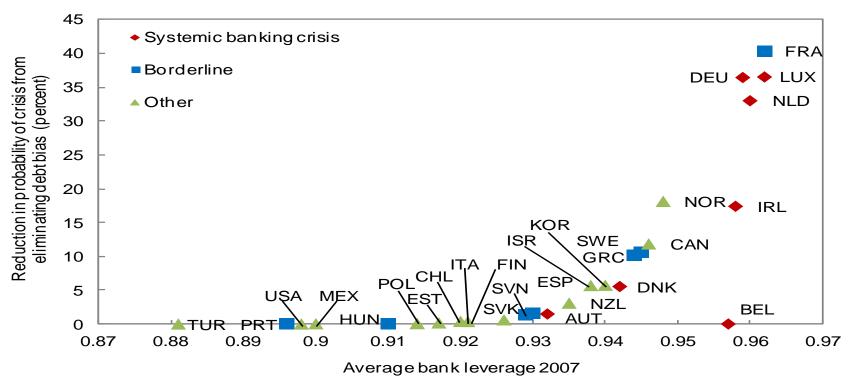
- Unless offset at personal level, deduction of costs of debt but not equity finance creates bais towards debt finance
  - Likely to be high when statutory CIT rate high

- Empirical evidence confirms such an effect
  - De Mooij (2011)

#### Does this matter?

Effect just as strong for banks—so, with tax linked to leverage and leverage to probability of crisis:

Figure 3.1. Debt Bias and Probability of Crisis



Sources: IMF staff calculations using results in de Mooij and others (2013) and identification of systemic banking crises of Laeven and Valencia (2010).

## Two approaches to eliminating debt bias....

### Allowance for Corporate Equity (ACE)

- Retain interest deduction, but also allow deduction for a notional return on equity
  - Variant: Allowance for Corporate Capital (ACC) would give notional deduction for debt at same rate
- This is a tax on rents:
  - Neutral between debt and equity
  - METR is zero
  - And rate of depreciation becomes irrelevant
- In practice: Italy, Brazil, Belgium, Croatia....

#### But some issues....

- What notional rate?
- ACE is base-narrowing
  - Effect can be limited by giving allowance only for equity created after introduction
- May nonetheless need higher statutory rate to preserve revenue at unchanged base
  - Which would amplify risks of profit shifting
- Though lower METR should be good for growth

#### Comprehensive Business Income Tax (CBIT)

- Eliminate CIT interest deduction
- (Very) base broadening
  - Mechanically, allows large reduction in statutory rate
  - But potentially large increase in M/AETRs..
  - ..and pressure to cut personal taxes on interest?
- No fully-fleshed proposals
  - Treasury Blueprints 1977

## Tax competition

## ...is happening

- Strong evidence of strategic tax interactions
  - Not just common 'fads'
- And tend to be both (a) in direction of 'race to the bottom' and (b) large
  - Devereux, Redoana and Lockwood (2008)

...though the race is taking some time

### The basic challenge...

Loosely, risk is greatest where only 'source' taxes are payable and 'source' is manipulable

How can this be addressed?

## ...and solutions in present framework?

- Full residence taxation without deferral
  - But inversion?

- Failing that, make shifting harder and use CFC rules
  - But leaves scope for competition on 'active' income?

Look later at ideas for changing the framework

#### Some politics

- While there is a collective loss, some countries can be winners
  - ..and collective loss cannot be inferred from observed extent of aggregate revenue loss
- Unlike e.g. trade context, small countries can be influential
- Larger now more willing to exercise power?

## 'Harmful' tax competition? Two questions

### When is tax competition <u>not</u> harmful?

- 'Tame the beast' argument
  - now less heard

- To extent tax competition takes form of providing most mobile activities with lower METR, enhances efficiency?
  - But not an argument for low EATR

#### Are preferential regimes harmful?

Suppose a country has CIT of 20% and an IP box

If the IP box were not possible, might cut CIT to 18%—would that be a good thing?

Better to compete aggressively over most mobile things or less aggressively over everything?

#### Regional coordination

- Presumably easier than global
  - Though still hard! And one reason may be:
- By coordinating among themselves, participates risk becoming more vulnerable to competition from rest of the world
- Biggest winners are those who remain outside

## Different international architectures?

#### Formula apportionment

(e.g. CCCTB)

- Base is consolidated profit of the group, which is allocated across jurisdictions by some apportionment factors
  - A form of which is used in Japan
- Eliminates need to value intra-group transactions

But...

#### ...all the action is in the weights

- Which factors to use?
- Competition to attract factors—maybe more intense than that to attract capital under ALP
- ALP challenges remain if operates only up to some 'water's edge'

#### Formulary profit split

(Avi-Yonah et al)

- Use third party prices where available...
  - E.g. fixed mark up on such purchases

...and apportion 'residual profit' that remains (by sales?)

Little studied, but, e.g.,

- Can have positive liability when group makes loss
- But may lead to less intense tax competition

#### Destination-based corporate tax

(Auerbach, Devereux and Simpson)

E.g. a cash flow tax but (a) exclude receipts from exports and (b) no deduction for imports

- Effectively a VAT plus wage subsidy
  - and hence has attractive neutrality properties: e.g. transfer prices irrelevant
- But then why not a VAT plus lower labor tax?

## THE END!

#### References

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#### Data sources

EATRs and METRS (for plant and machinery):

Bilicka and Devereux, 2012, CBT Corporate Tax Ranking 2012, Oxford Centre for Business Taxation

Rest: IMF