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Discussion of
« Territoriality, Worldwide Principle, and
Competitiveness of Multinationals:
A Firm-level Analysis of Tax Burdens »
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Overview

- Summary of the main findings of the paper
- Policy issues

Summary

- Historical / Tax Fact:
 - Since Japan and the United Kingdom adopted a territorial system in 2009, the United States remains the only major country with a worldwide taxation system for corporate income.
- Behavioural implications of those tax systems

Two systems for taxing MNE's

- Territorial system:
 - profits are taxed locally (source principle) and repatriations are tax exempt => local tax rates matter : delocating an investment => shifting tax liabilities
- Worldwide system:
 - Profits are taxed at parent level (residence principle) and local taxes are credited on parents tax liabilities up to that amount = > if effective tax rate larger at residence, that latter rate matters => no incentive to shift tax liabilities

Behavioural consequence

- If worldwide applies and parent country effective tax rate is higher – otherwise it turns out to be territorial equivalent – then MNE pays more taxes.
 - “Under territorial system companies have an incentive to maximise group profit by locating their real activities, and shifting some earnings, into low-tax jurisdictions.
 - “Under worldwide system of taxation, incentive is smaller as foreign profits are taxed at the same rate as domestic profits when and if they are repatriated.
 - This could imply a higher tax burden for companies headquartered in worldwide countries. »

A Historical / Tax Fact

- Since Japan and the United Kingdom adopted a territorial system in 2009, the United States remains the only major country with a worldwide taxation system for corporate income.

A US Tax Policy issue

- Whether
 - to keep worldwide taxation allowing US authorities to levy a higher tax rate, or
 - to move to territorial taxation and a lower tax rate
- Why ?
 - At the heart of this discussion lies the concern that the current tax system hampers the competitiveness of US multinationals, at least if they repatriate profits to the US

Purpose and Methodology

- Through a firm-level panel for 15 OECD countries, comparing the tax burden of MNE's with HQ in worldwide countries with that of MNE's with HQ in territorial countries.
- Tax burdens measured in two ways:
 - by a Marginal Effective Tax Rate (METR): the increase in MNE tax liabilities when profits increase by one US dollar,
 - by a new Marginal Effective Tax Base (METB): the increase in the tax base for an additional dollar of accounting profit.

NB. METB allows (1) to isolate effect of CIT Rate and (2) to assess whether higher burden comes from higher rate or larger base

As usual, the paper

- Surveys the literature
- Presents the data
 - Makes use of ORBIS from Bureau van Dijck
 - 3,389 groups over 2003-2007 and 15 OECD countries
 - GUO (Global Ultimate Owners) are identified
 - Domestic
 - Multinationals
 - With / without a subsidiary in a Tax Haven

As usual, the paper

- Develops a theoretical model showing a.o.
 - if the deductions on the tax base in H are smaller than the deductions on the tax base in F, the METB of a group hq in a worldwide jurisdiction will be larger than the METB of a MNE hq in a territorial jurisdiction.
 - NB – less clear – ” in the empirical analysis Tax Rate in F is approximated with Tax Rate in H, the statutory corporate tax rate in the jurisdiction where the corporate group is headquartered. » Why?

As usual, the paper

- Produces empirical results – main are in Table 9 – on which
- It bases conclusions, especially three
 - see next slides

Conclusion 1

- METR of companies hq in worldwide jurisdictions is 19/18 points higher than the METR of groups hq in territorial jurisdictions,
 - More specifically, companies hq in the United States are characterised by the highest METR (19/16 higher than territorial) and UK companies by the second highest METR (12 higher than territorial) – consistency of figures?
 - But when one controls for statutory rates, that difference disappears so that differences in METRs are mainly driven by statutory rates.

Conclusion 2

- The METBs of groups hq in territorial countries are not statistically different from METBs of groups hq in worldwide countries,
 - there is no statistically significant difference in how an additional dollar of accounting profit translates into additional tax base.

Conclusion 3

- The paper also investigates whether a territorial system for the taxation of corporate profits is more vulnerable to tax avoidance activities, and shows
 - evidence consistent with tax haven operations reducing tax liabilities in both, but more in territorial systems.
 - MNE's hq in territorial countries reduce their METR and their METB more than groups hq in a worldwide country.
- This differential influence of tax haven subsidiaries in territorial jurisdictions is robust to controlling for statutory tax rates.

Discussion and Policy issues

- Worldwide taxation characterized by higher METR driven by higher CIT statutory rate and a higher protection against tax avoidance by MNE's is better (worse) for governments (MNE')
 - but is that result not also, or more accurately, driven by the fact that worldwide countries also have stronger CFC and other anti-abuse instruments? Or simply they are more powerful countries (Worldwide is a proxy for dominance?)

Discussion and Policy issues

- If true
 - Why has UK given up that system, and Japan as well?
 - Why is it not recommended as a coordination device at international level?
- Because Worldwide Taxation + CFC means gains for the very large countries while smaller jurisdictions are better off in a setting where tax competition might be possible?

- Which country gains and which country loses shifting from one system to the other? Is an all territorial or an all worldwide Pareto superior? Or a mixed one?
- A key question for EU tax construction:
 - Should CCCTB be adopted within an Enhanced Cooperation Agreement framework, could an EUwide tax base (including non consolidating countries) + CFC be an efficient protection against those brother countries despite the decisions of the ECJ (Cadbury-Schweppes)? (Gérard-Traversa, 2010)