The New Non-Territorial U.S. International Tax System

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The death of a bad frame

"Worldwide or territorial"???

2017 tax act: the dog catches the bus.

Repealing deferral ≠ "going territorial."

The U.S. replaces "now or later" taxation of FSI with "now or never," but significantly expands "now."

Without endorsing what Congress did, it helped show that underlying issues have at times been misapprehended.

Beyond "WW vs. territorial," part 1

They differ at 2 margins, not one:

(1) Tax rate for FSI: same as domestic rate in pure WW; 0% in pure territorial.

(2) Marginal reimbursement rate (MRR) for foreign taxes: 100% in pure WW; implicit deductibility (same as MTR) in pure territorial.

Obliviously conflating these two sets of issues is not conducive to clear thinking or good analysis.

Beyond "WW vs. territorial," part 2

Why only consider polar alternatives at each of the 2 margins?

Why the arbitrary linkage between approaches at each margin?

If everything's a "hybrid," the term is neither informative nor interesting.

"WW vs. territorial" also fails to illuminate margins that countries actually seem to care about (as per 2017 tax act).

(1) ETRs for MNCs vs. domestic companies

Even after tax competition –> lower corporate rates, allow lower ETRs still for (relatively mobile) multinationals?

If yes, then optimal tolerated profit-shifting may > 0.

But can also become "excessive" (e.g., rents; domestic vs. foreign companies; residents individuals' labor income).

May want to tax FSI @ between zero & full domestic rate; may also want to over-measure MNCs' domestic source income that one suspects was over-shifted.

(GILTI, BEAT)

(2) Taxing resident vs. foreign MNCs

To have CFC rules is to treat the 2 types of MNCs differently, including re. profit-shifting.

May favor this even if they're not systematically different.

For resident MNCs, ability to tax "bad" FSI allows for a more refined tool.

Tradeoff; US pre-2017 act appears to have over-focused its anti-profit-shifting efforts on resident MNCs.

(BEAT)

(3) Identifying "bad" FSI

Considerable consensus on what it is & how to define it.

CFC rules are anti-tax haven rules, whether they focus on where profits actually reported or on what's easy to shift.

But a lack of consensus (between & within countries) on how rigorously to address it.

Why want foreign taxes on FSI to be high rather than low?

But tax haven income may indicate undesired / "excessive" domestic base erosion.

(GILTI)

(4) MRR for foreign taxes

FTCs' MRR of 1 for foreign taxes is clearly too high (though in U.S. practice was mitigated by deferral).

Same problem can arise under a global minimum tax.

Foreign tax deductibility (including implicit from exemption) would be unilaterally optimal but for the "bad FSI" issue.

(GILTI)

An issue with all these issues

No consensus about any of them! (Although plenty of self-confidence on both sides.)

None is well understood – need better-focused empirical work!

Answer for each may vary between countries & across time.

Each offers a Goldilocks question ("too hot, too cold, or just right"?). No clear or clean analytic answers.

A quick word on the 2017 changes

BEAT & GILTI are in the ballpark of addressing significant concerns that lack clear answers.

But big conceptual & design problems with each, even taking as given the aims & degree of rigor.

Each could be significantly improved – but will they be?

FDII would also be in the ballpark (lower tax rate on mobile DSI) – if it weren't an export subsidy, & hence verging on indefensible economically, legally, & administratively.