

Profit Shifting Before and After TCJA

NTA Spring Symposium

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Profit Shifting Before:

How big was profit shifting in 2017?

Profit Shifting After:

What does the TCJA do?

How will the minimum tax affect US and foreign tax bases, once adjustment is complete?

How Big Is Profit Shifting?

- Abundant evidence of a very large problem.
- Magnitude depends on data source.
- Widely used databases (like Orbis) are nearly useless for this question, since haven income is simply missing.

Yet \$3 trillion of \$4.2 trillion of reported accumulated foreign earnings in US country-by-country data (2017) are in havens, ignoring stateless numbers.

Popular Data Sources

Orbis / Compustat = Company level data yet...

- Misses almost all haven income
- Nonlinearities are important => havens key
- Big companies do most shifting; don't treat all companies the same; the tail is different (Wier and Reynolds)
- Many companies report positive accounting profits and zero tax profits (Bilicka) => accounting data underestimates

Don't look under the lamppost for your keys if you dropped them in the dark.

Other Data Sources

- BEA
 - Direct investment earnings series (preferred)
 - Net income (but double counting)
 - Subtracting equity income loses some profit shifting (among foreign countries); foreign to foreign shifting is important.
 - In aggregate data, companies w/ losses make effective tax rates look too high
- Tax Data (form 5471); can omit dividends but long lag
- Country by Country Data (form 8975; preferred)

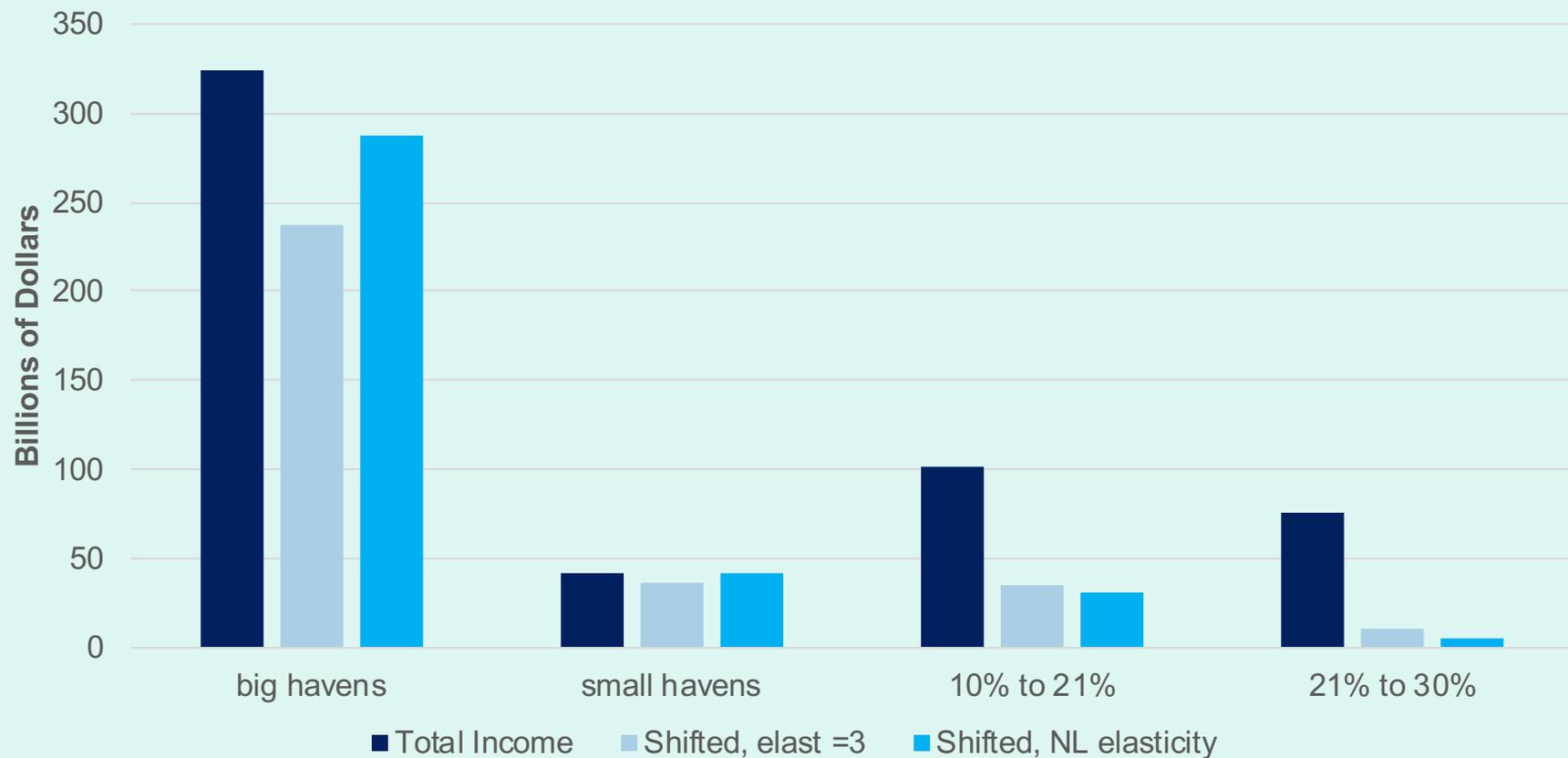
A Comparison of US Data Sources

	<u>Adjusted Method (BR)</u>	<u>BEA Balance of Payments Direct Investment Income</u>		<u>IRS Country-by-country Data (income series are before tax)</u>		
	Net inc. ⁺ for. tax-equity inc.	after tax (reported)	before tax (calculated) ⁵⁷	Full Sample	Positive Profit	Accumulated Earnings
All countries⁵⁸	571,007	470,933	574,958	638,467	873,621	4,240,635
<i>Stateless (omitted from totals and subtotals)</i>				203,571	215,170	690,583
Puerto Rico				34,335	35,236	114,439
Ireland	82,519	51,804	55,930	29,478	34,221	103,961
Luxembourg	6,484	36,825	38,734	24,866	60,438	357,328
Netherlands	58,676	76,083	81,120	40,010	69,964	461,814
Switzerland	37,696	30,474	34,332	49,376	59,204	374,797
Bermuda	-10,431	32,341	33,215	32,476	35,433	634,413
UK Caymans ⁵⁹	20,675	33,235	33,888	58,540	62,369	142,467
Singapore	35,270	24,496	27,529	54,642	56,788	174,888
Big Haven Total	230,889	285,258	304,748	323,723	413,653	2,364,107
Big Haven Share	40%		53%	51%	47%	56%

Possible Scale of US Revenue Loss from Profit Shifting in 2017

	BEA Direct Investment Income Series (balance of payments data; adjusted pre-tax)	BEA Adjusted Income Series (removes equity income from income, using BEA survey data)	IRS Full Country-by-Country Sample (without stateless income)	IRS Average of Full and Positive Profit Country-by-Country Sample (without stateless income)
Assign all havens ¹⁹ the world average profit/employee ratio	\$79 billion	\$61 billion	\$96 billion	\$118 billion
Remove tax elasticity; reallocate profits, linear elasticity	\$75 billion	\$67 billion	\$96 billion	\$122 billion
Remove tax elasticity; reallocate profits, nonlinear elasticity	\$89 billion	\$76 billion	\$109 billion	\$141 billion

Where are the profits (and the shifted profits)?

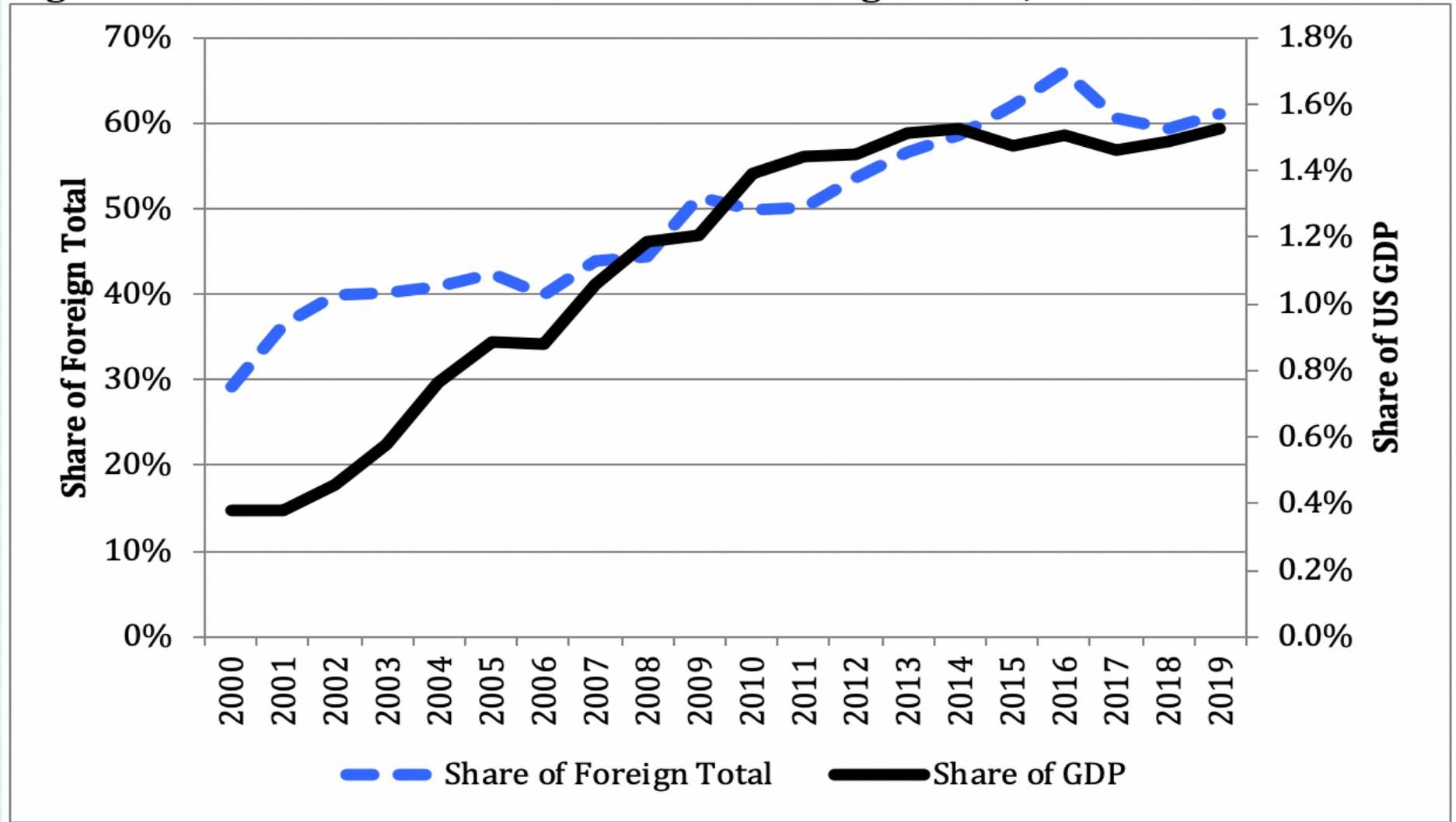


What does TCJA do?

	Effect on Profit Shifting	10y JCT Revenue, \$b
Statutory Corporate Rate	Reduced incentive to shift out of US base	-1,349 (net: -654)
Territorial Tax Treatment of Foreign Income	Increased incentive to shift out of US base	-224
Global Minimum Tax	Reduced incentive to shift profits to havens; increased incentive to earn in other countries	112
Foreign-Derived Intangible Income Deduction (FDII)	Likely to have negligible effect	-64
Base Erosion and Anti-Abuse Tax (BEAT)	Reduced incentive to shift income out of US base	150

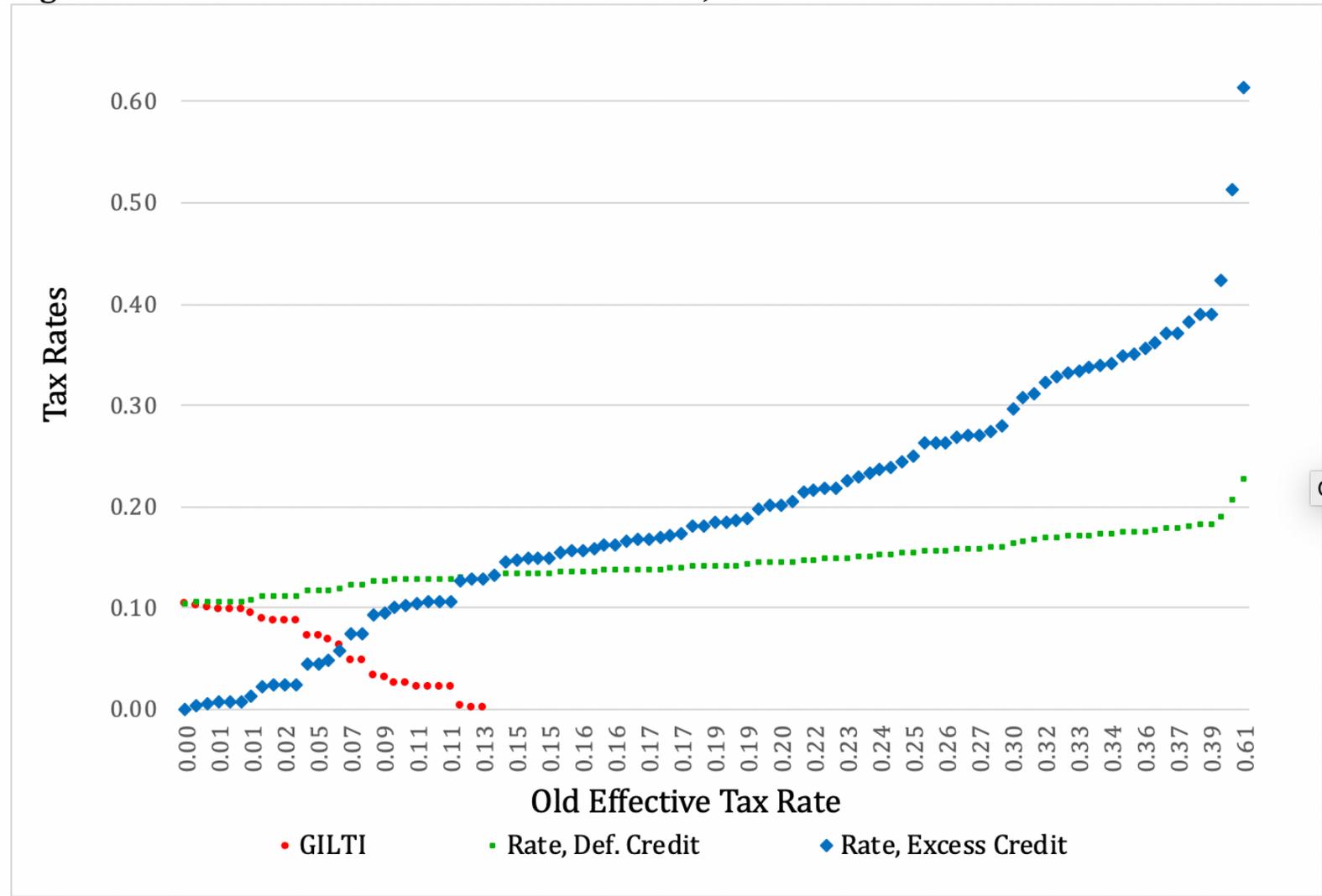
What is the net effect so far?

Figure 2: Share of US MNC Income in Seven Big Havens, 2000-2019

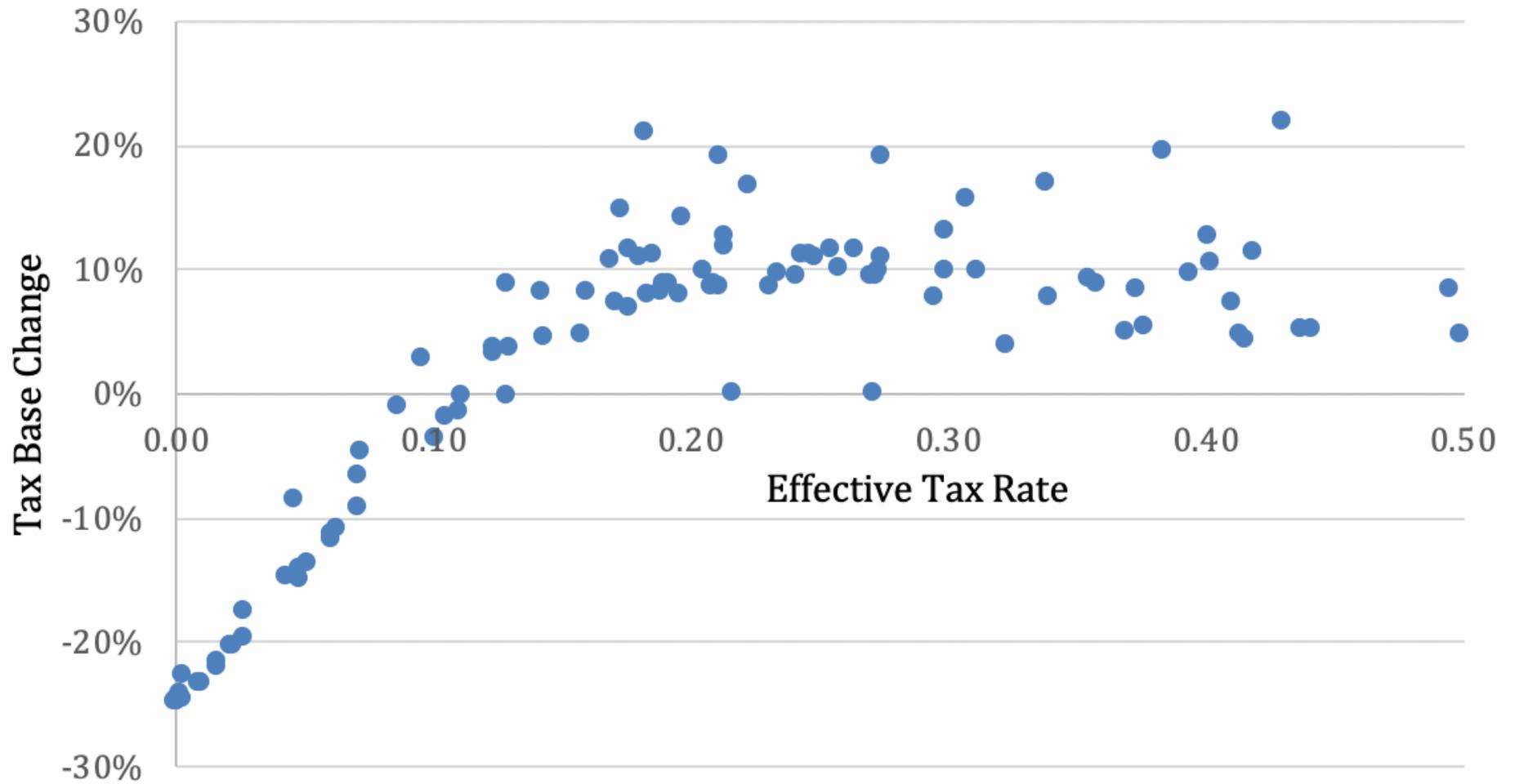


What does the global minimum tax do?

Figure 3: Effective Tax Rates for GILTI Income, Before and After TCJA



How will it affect US MNC tax bases abroad?



How will it affect US MNC tax bases?

Table 3: Changes in Corporate Tax Base Due to GILTI Global Minimum Tax

	BEA DII Series		IRS <u>CbC</u> Series	
	Tax Base Change, billions	Tax Base Change, percent	Tax Base Change, billions	Tax Base Change, percent
Min Tax Countries	-35.9	-11.7%	-55.1	-15.5%
Others, Non-Havens	18.3	8.1%	21.6	9.1%
Of which: Rich	13.0	8.0%	12.2	23.6%
Non-Rich	5.4	8.1%	9.5	5.1%
U.S.	16.6		29.8	
U.S. Revenue (\$b)	3.3		6.0	

Comparing a Per Country Minimum Tax

	Global Minimum Tax	Per-Country Minimum Tax
<u>BEA DII Series</u>		
Minimum Tax Country US Affiliate Tax Base (%)	-11.7%	-23.0%
Other Foreign Country US Affiliate Tax Base (%)	8.1%	7.9%
US Corporate Tax Base (billions USD)	\$16.6b	\$49.7b
Implied Additional US Revenue	\$3.3b	\$9.9b
<u>IRS CbC Series</u>		
Minimum Tax Country US Affiliate Tax Base (%)	-15.5%	-30.6%
Other Foreign Country US Affiliate Tax Base (%)	9.1%	9.3%
US Corporate Tax Base (billions USD)	\$29.8b	\$77.0b
Implied Additional US Revenue	\$6.0b	\$15.4b

Moving Forward from the TCJA

A Per-country Minimum Tax? A Higher Min. Tax Rate?

⇒ Essential Dilemma:

Tax base protection versus Competitiveness

Do we have the balance right?

Are there fundamental reforms that would make this trade-off less vexing?