Global Inequality & Growth:
Corporate taxation in a globalized world

Ludvig Wier

What we have learned so far:

- There are equity reasons for taxing capital
  - Remember 70% of capital in the US inherited
- But also potential efficiency concerns
- However so far we assumed a closed economy

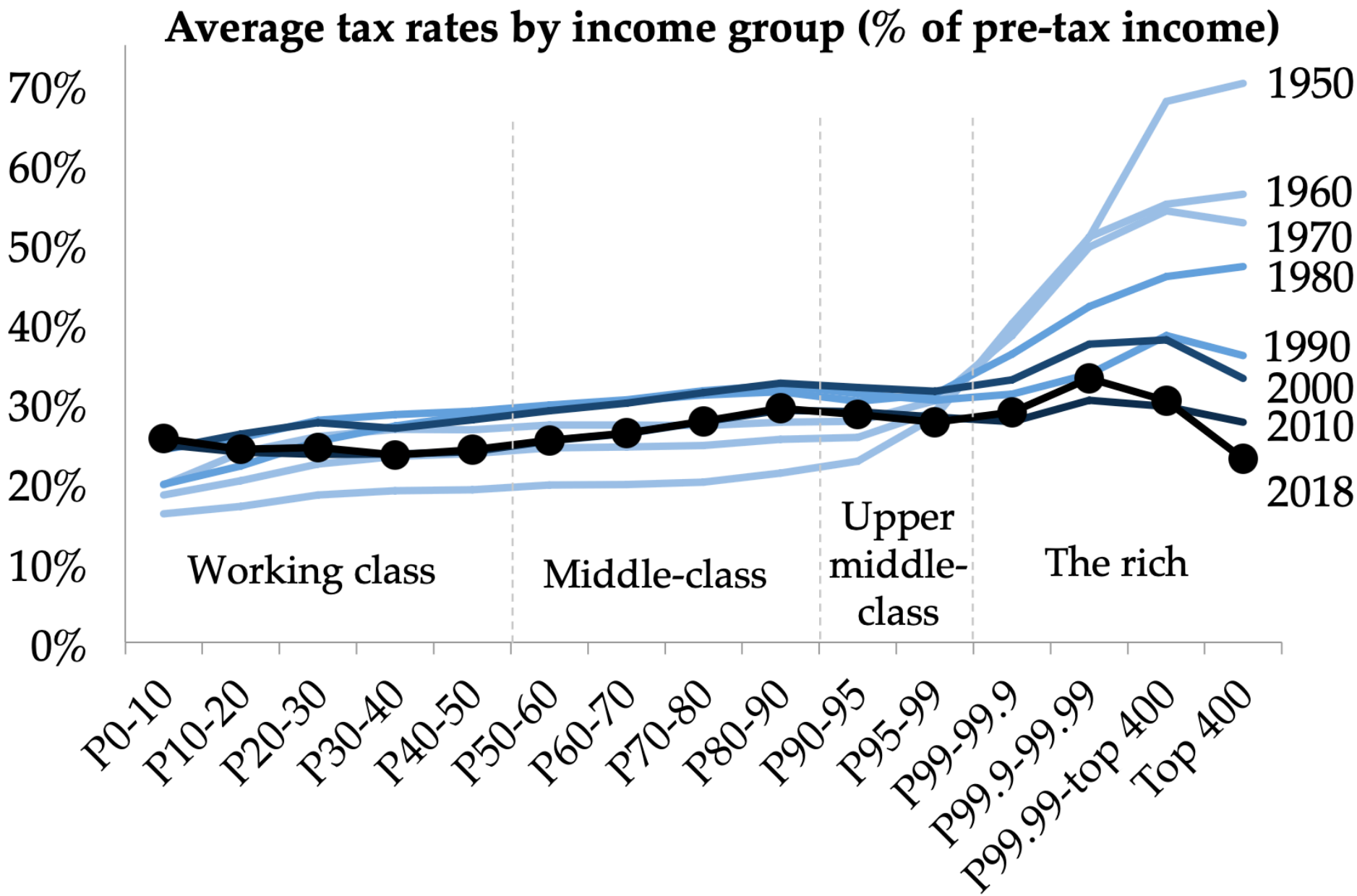
What we're going to learn in this lecture:

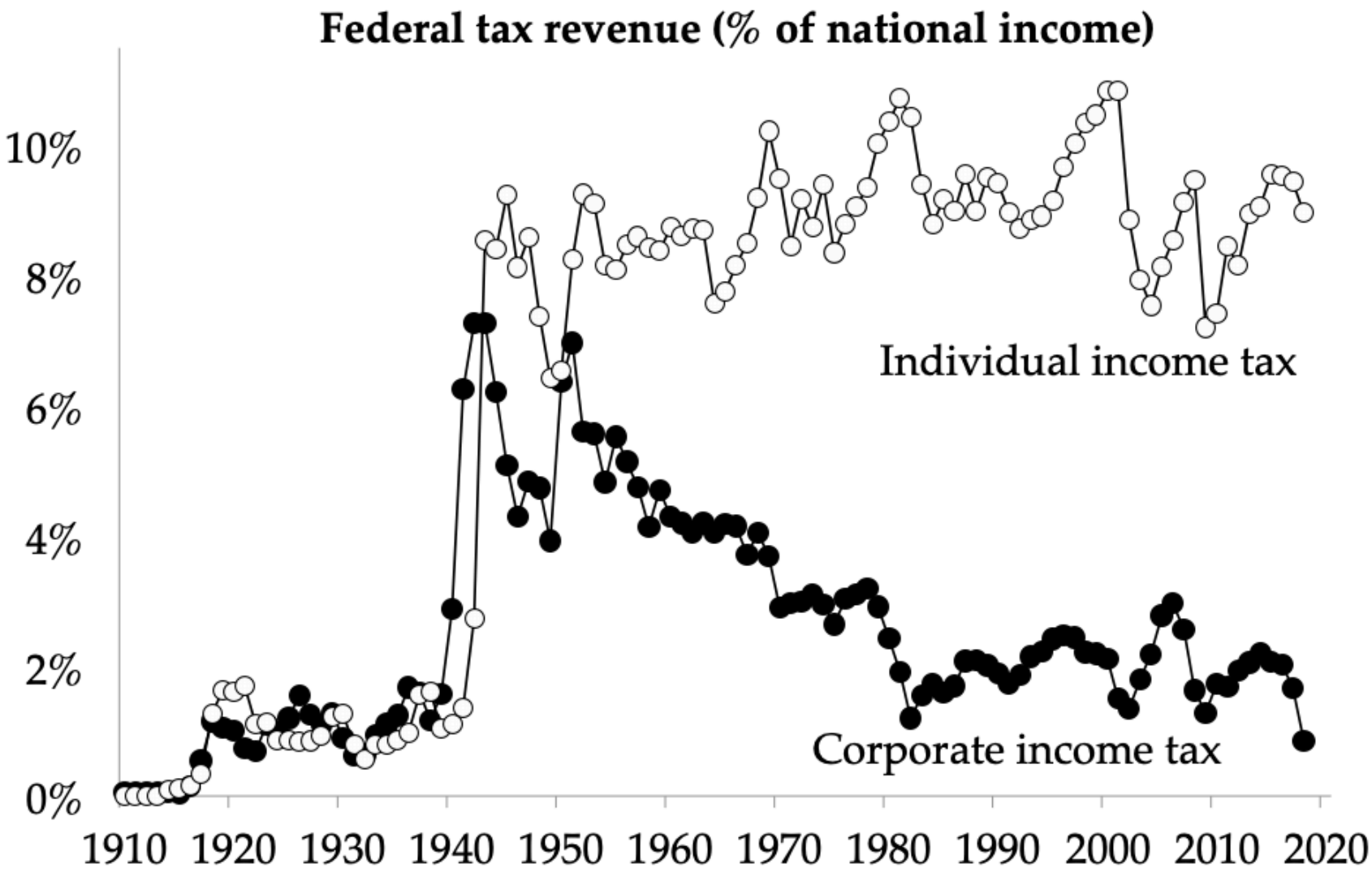
- The demise of the corporate tax
- How corporate taxes can be avoided in a globalized world
- How individual taxes are avoided (next time)
- Impact on inequality (next time)

Corporate taxation: the backstop of capital taxation

Shareholders own a corporation that earn $100Bn in profits – how will they be taxed?

- 1st corporate taxation: to be paid by the company (US≈25%)
- 2nd dividend taxation: to be paid when profits are transferred to shareholders (US≈20% long-term)
  - However, companies can decide not to pay dividends (retain earnings) – in which case dividend taxation is not paid
  - Additionally, foreigners will not pay dividend tax in the US


Average tax rates by income group (% of pre-tax income)
70%
60%
50%
40%
30%
20%
10%
0%
1950
1960
1970
1980
1990
2000
2010
2018
Working class
Middle-class
Upper middle-class
The rich
P0-10
P10-20
P20-30
P30-40
P40-50
P50-60
P60-70
P70-80
P80-90
P90-95
P95-99
P99-99.9
P99.9-99.99
P99.99-top 400
Top 400



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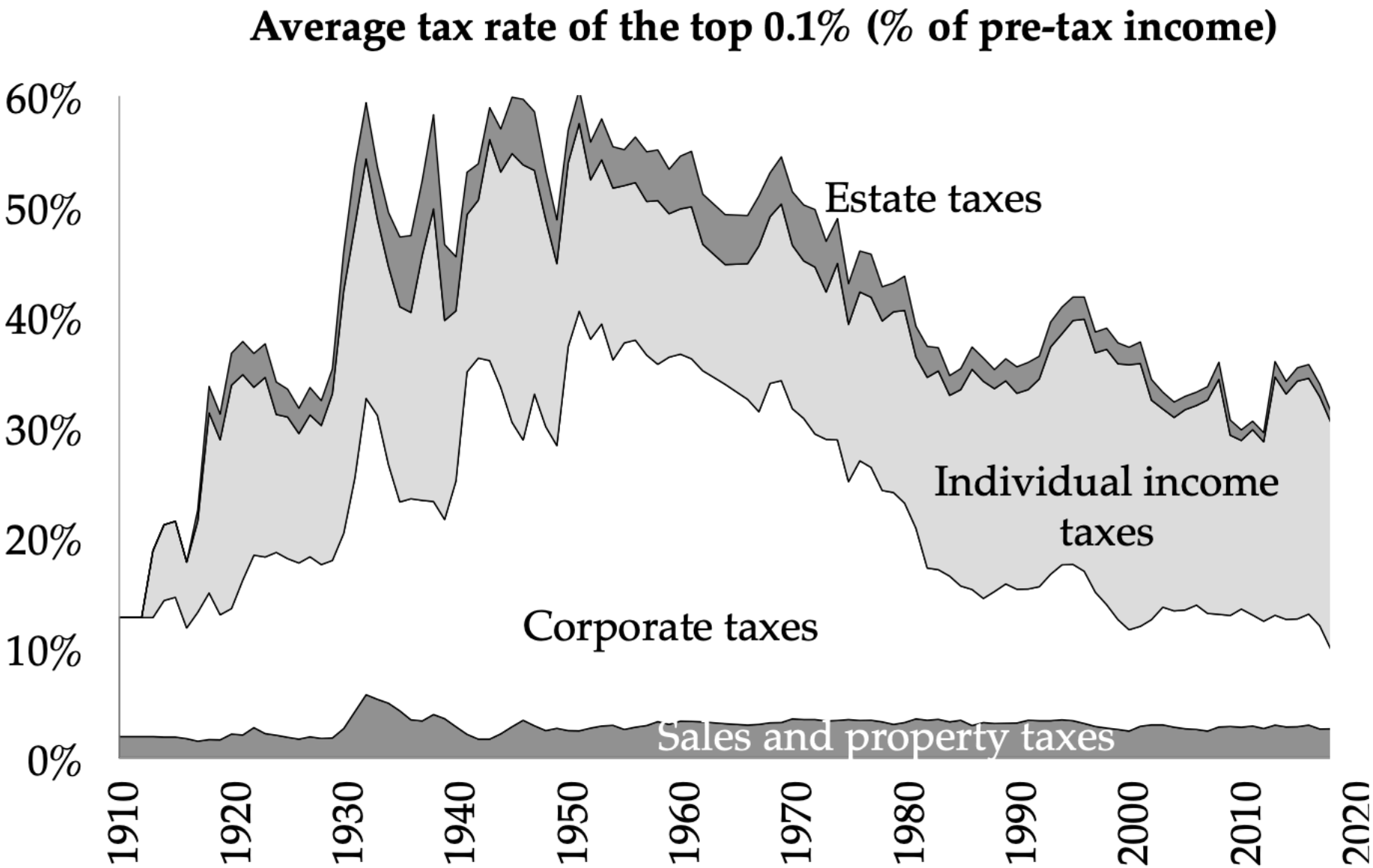

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Three main drivers of declining progressivity:

- Collapse in capital taxation
- Choice to tolerate certain forms of evasion. Let avoidance fester → slash rates → repeat .
  1. 1980s: individual income tax → Reagan 1986
  2. 2000s-2010s: corporate tax → Trump 2017
- Globalization in its current form: tax havens; tax competition.
- … not a force of nature! Reform is possible.

Corporate taxation is primarily source based

- Source/territorial taxation: taxed where the "value is created"
- Mother of all discussions on corporate tax: where is the value created?

Issues of current international tax law

Three main consequences of source-based taxation:

- Profit shifting to low-tax countries
- Relocation of capital to low-tax countries
- Tax competition leading to equilibrium where tax rates are too low

Hide and Seek for Professionals

How Corporate Profits Fled Taxation (and Where to Find Them)

By Ludvig Wier

UNIVERSITY OF COPENHAGEN

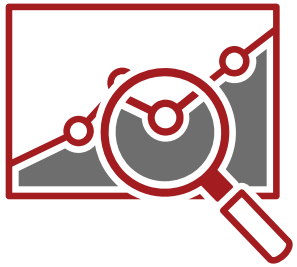
What are we discussing?

- Multinational firms ≡ firms that operate in at least two countries ≡ firms that operate in at least two tax-jurisdictions
- Countries have different tax rates!
- Reduce tax payments by reporting their profits where they are taxed at the lowest possible rate

Google (Alphabet)!

Bermuda!

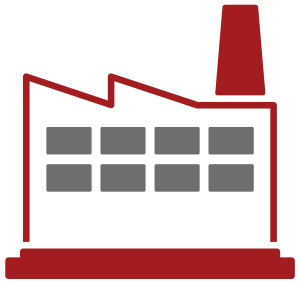
What are we discussing?



Profit shifting ≡ moving taxable profits across borders with no corresponding activity to save taxes

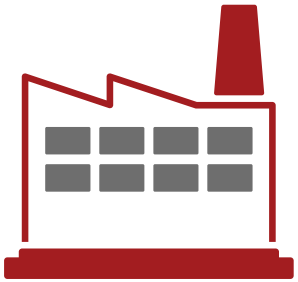
Example of profit shifting

Subsidiary 1:
Low tax country



Profits: $1Bn.
Corp. tax = 0%
Taxes paid = 0

Subsidiary 2:
High tax country



Profits: $1Bn
Corp. tax = 20%
Taxes paid = $0.2Bn

Example of profit shifting

Subsidiary 1:
Low tax country

Subsidiary 2:
High tax country

Profits: $2Bn.
Corp. tax = 0%
Taxes paid = 0

Profits: $0Bn
Corp. tax = 20%
Taxes paid = 0

Not an example of profit shifting

Example of profit shifting

Subsidiary 1:
Low tax country

Subsidiary 2:
High tax country

Profits: $2Bn.
Corp. tax = 0%
Taxes paid = 0

Profits: $0Bn
Corp. tax = 20%
Taxes paid = 0

How is this possible in the first place?

International tax law cuts up multinational firms at country borders

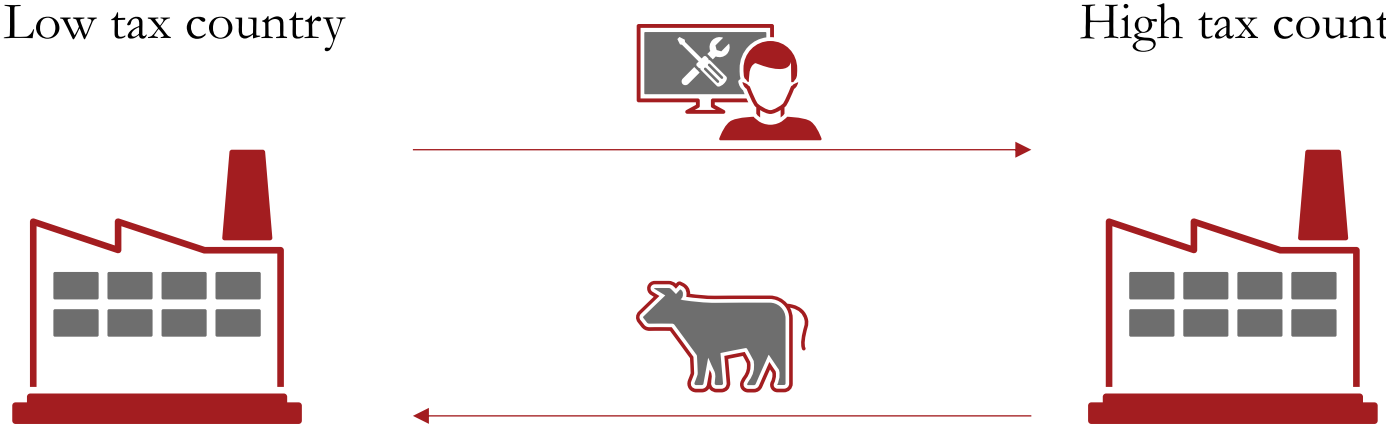
How is this possible in the first place?

International tax law forces multinational firms to transact with themselves!

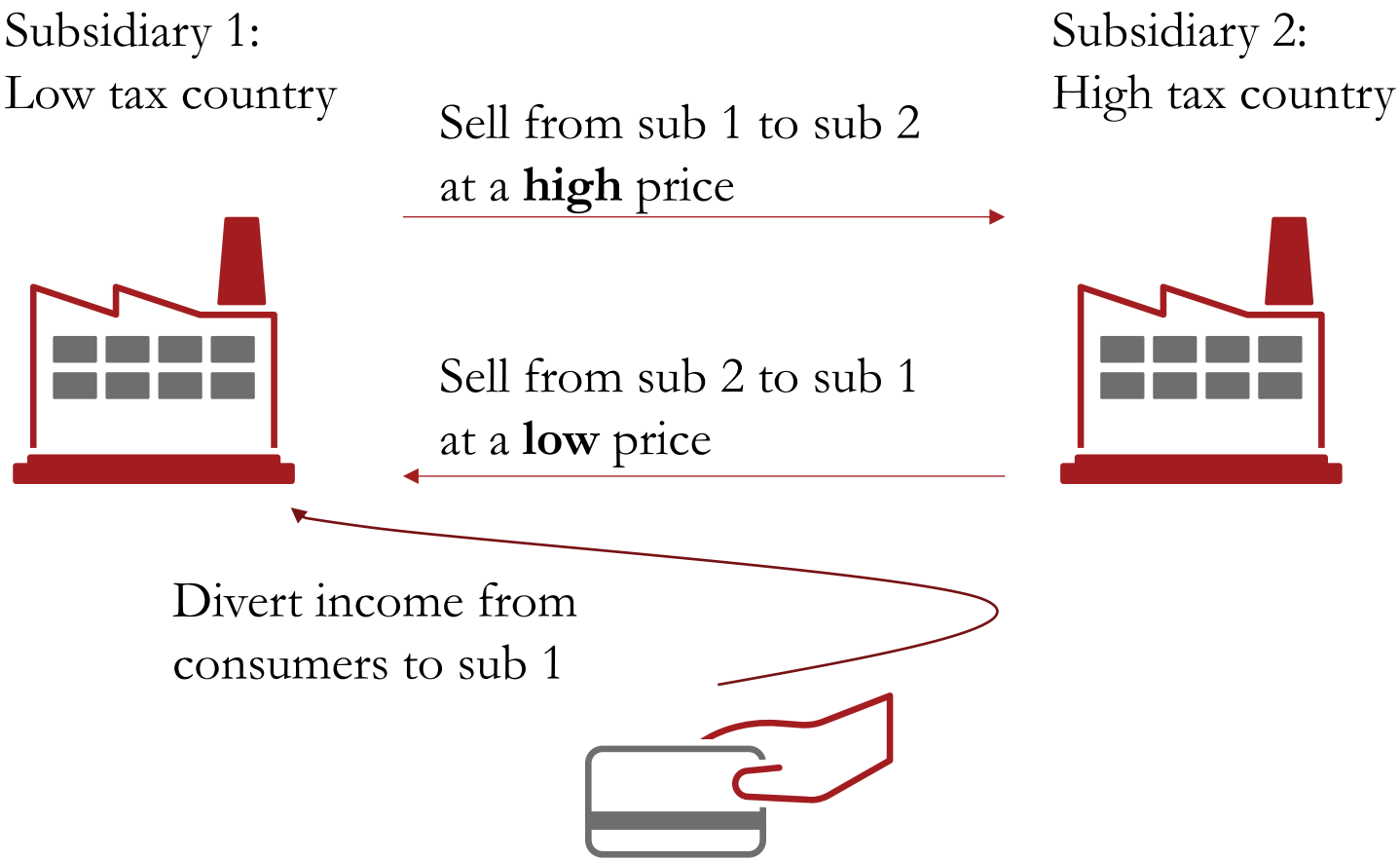
Every time multinational firms interact across subsidiaries a fictional price is computed

Subsidiary 1:
Low tax country

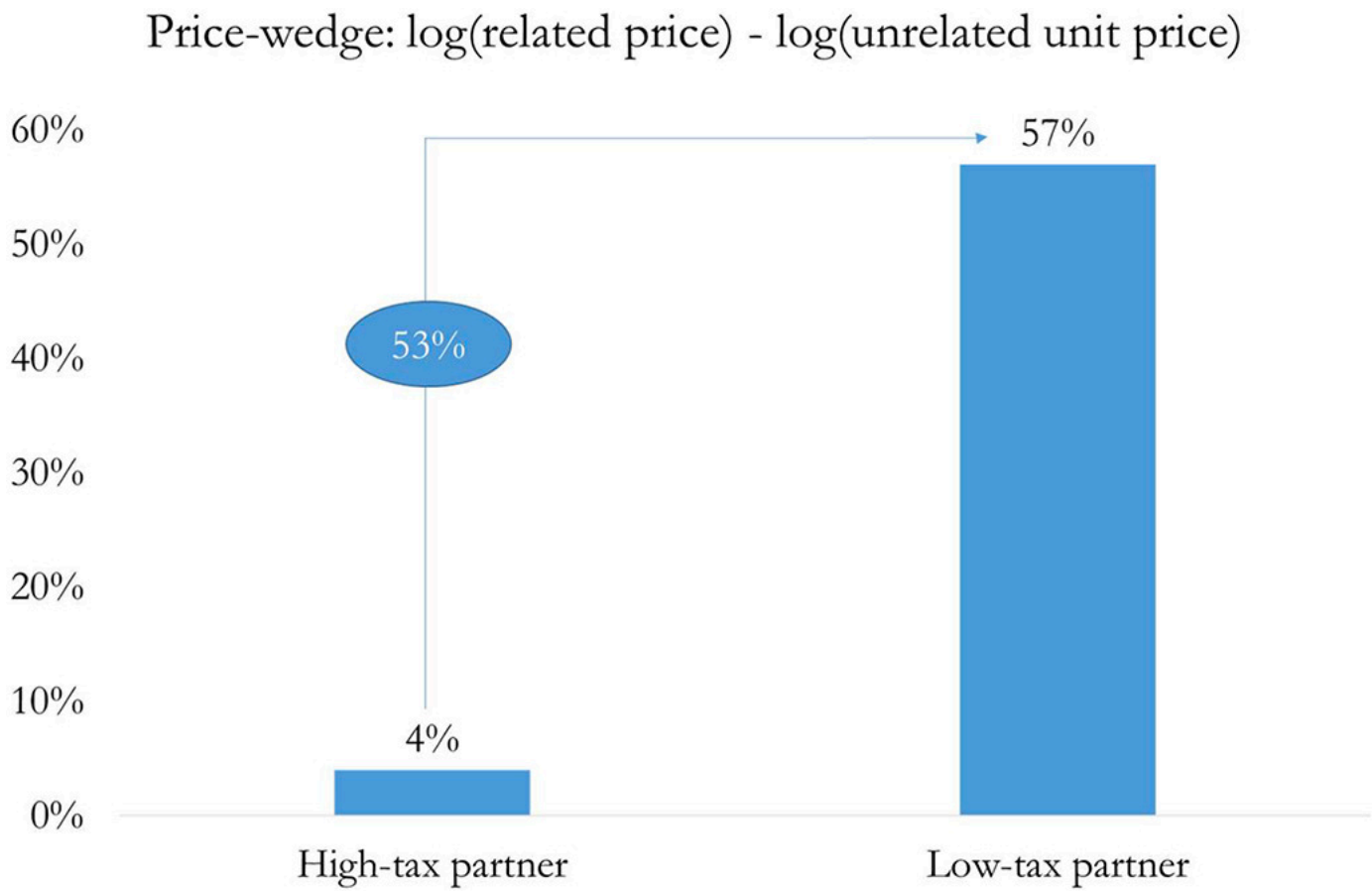
Subsidiary 2:
High tax country



How do you profit shift in practice?

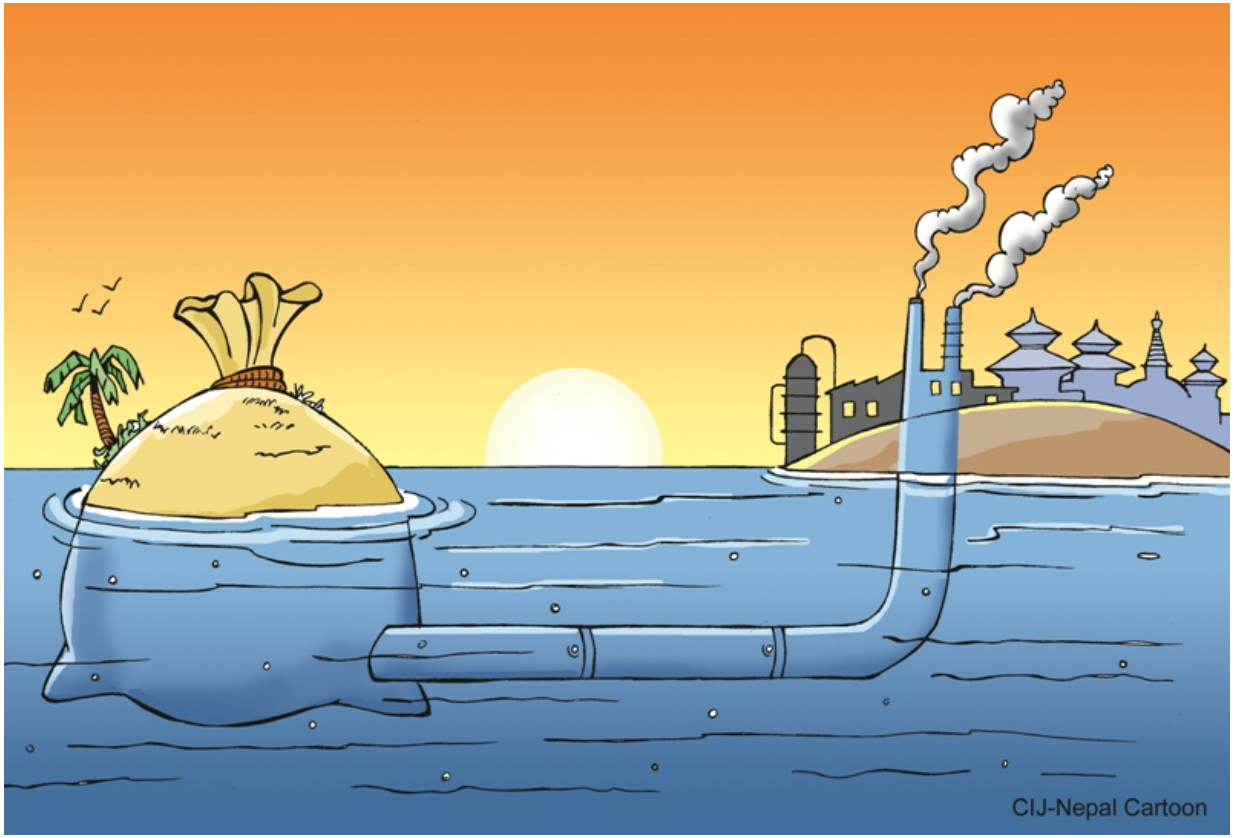


Case of South Africa:



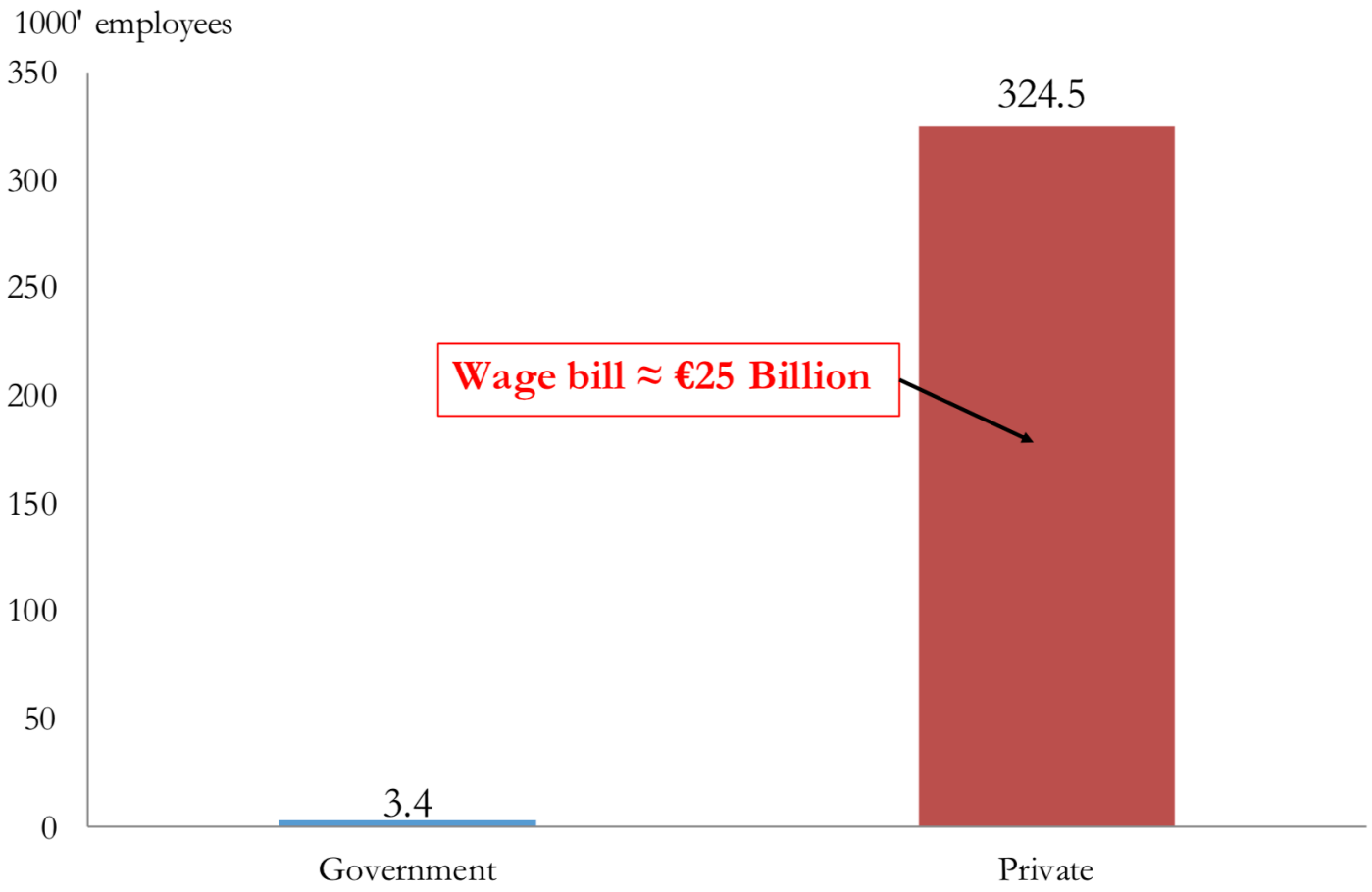
Wier (2020)

Kahoot! You want to shift profits to a tax haven … how do you proceed?



Is this legal?

Figure 1: Private vs public employment in transfer pricing



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How did we get this system?

Four economists got together 100 years ago when there where no multinationals and designed the international tax laws

The big picture

Multinationals are on the rise

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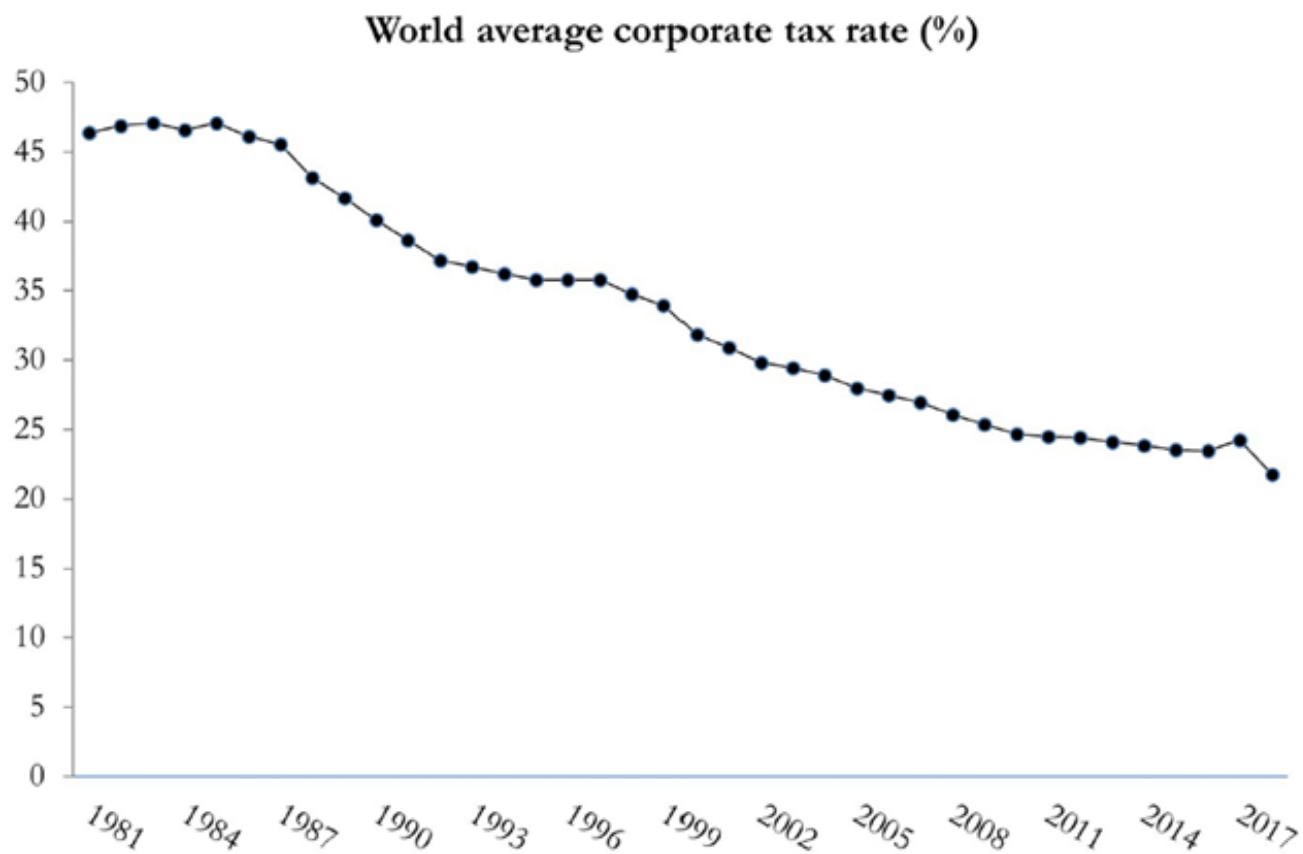
Race to the bottom



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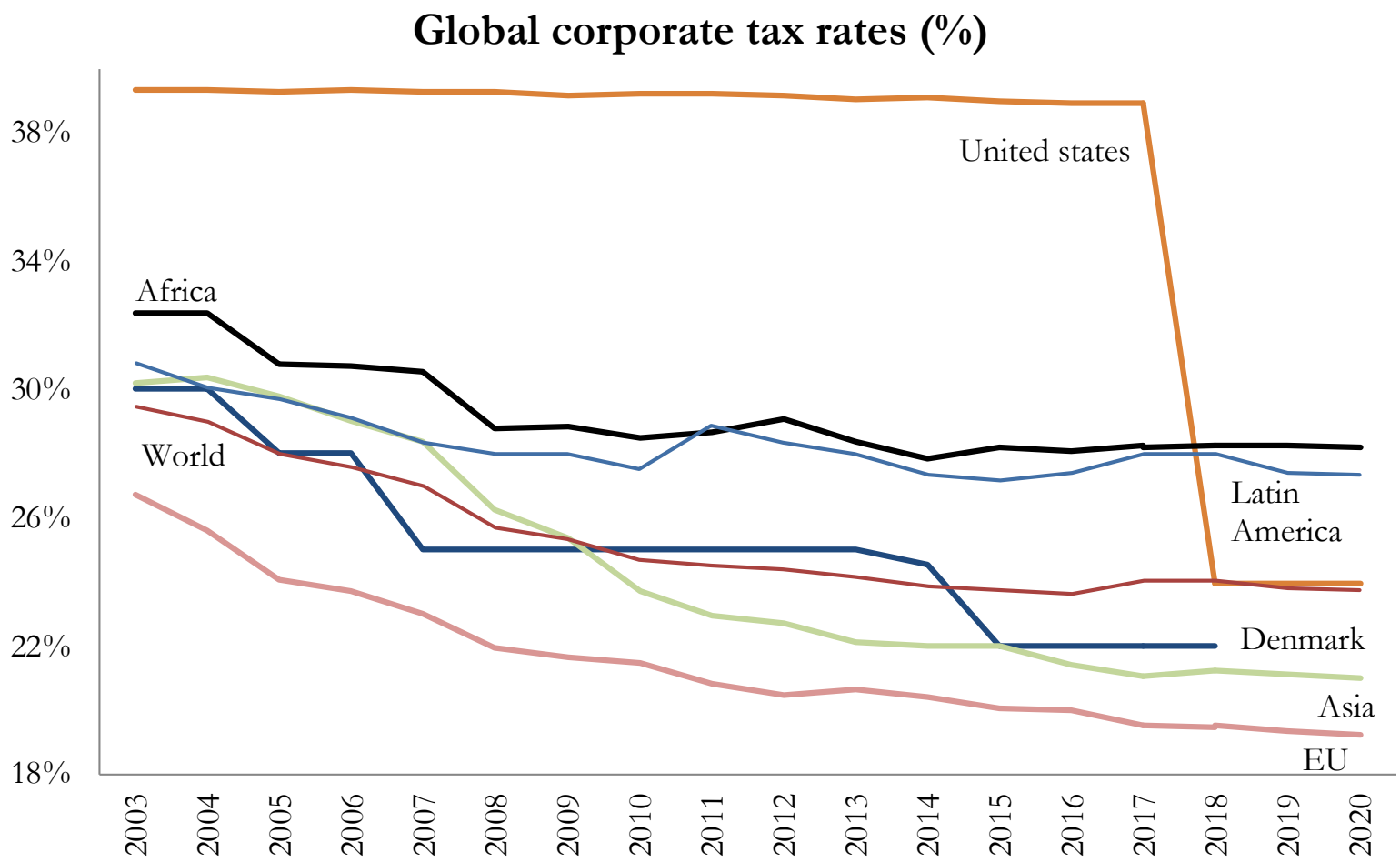
Corporate tax rates are plummeting



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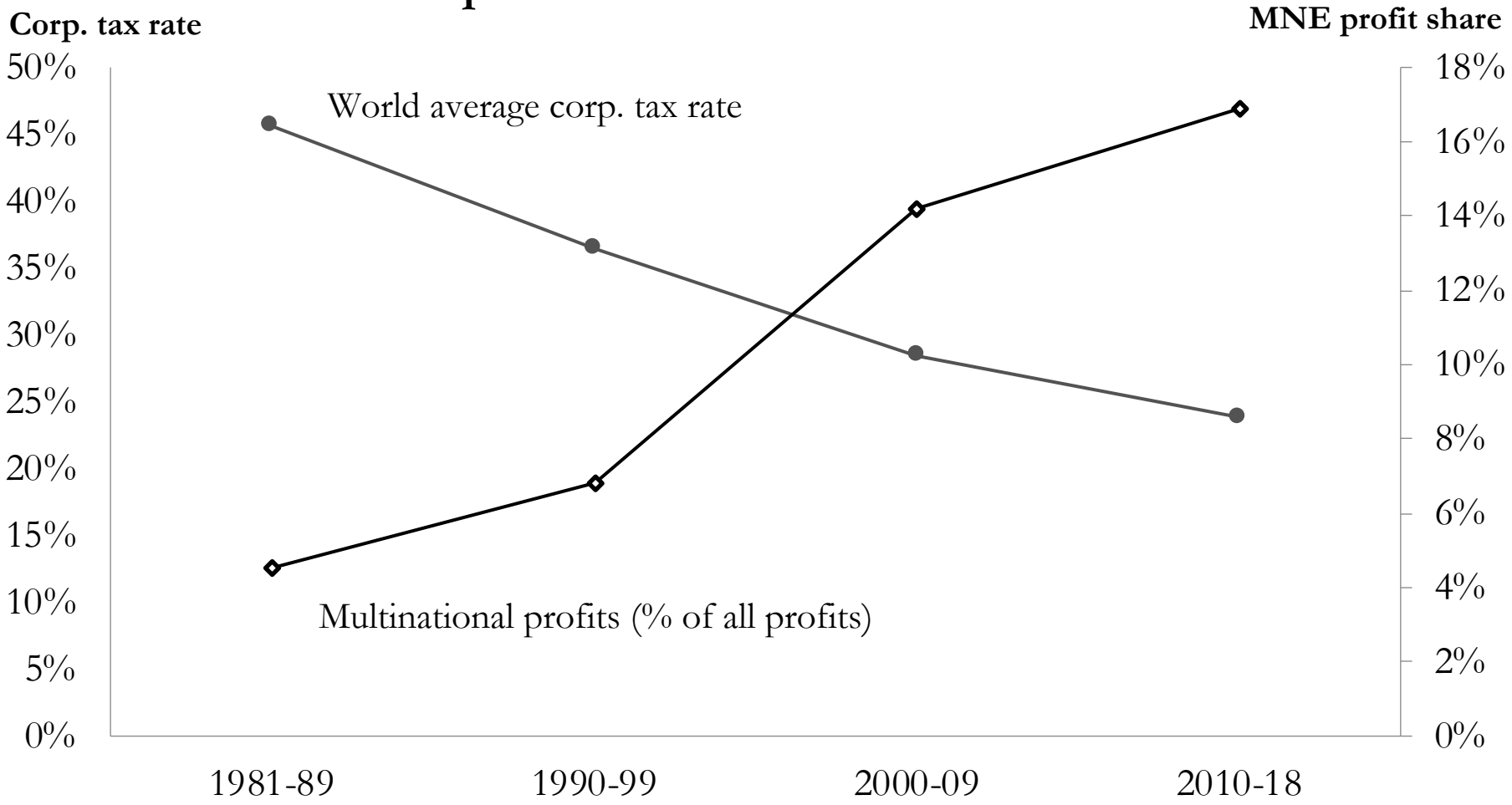
Tax competition and the rise of multinationals



Notes: This figure charts the unweighted world average corporate tax rate and the share of global corporate profits made by multinational corporations. Multinational profits were around €1.4 trillion in 2015, while global corporate profits were around €7.9 trillion.

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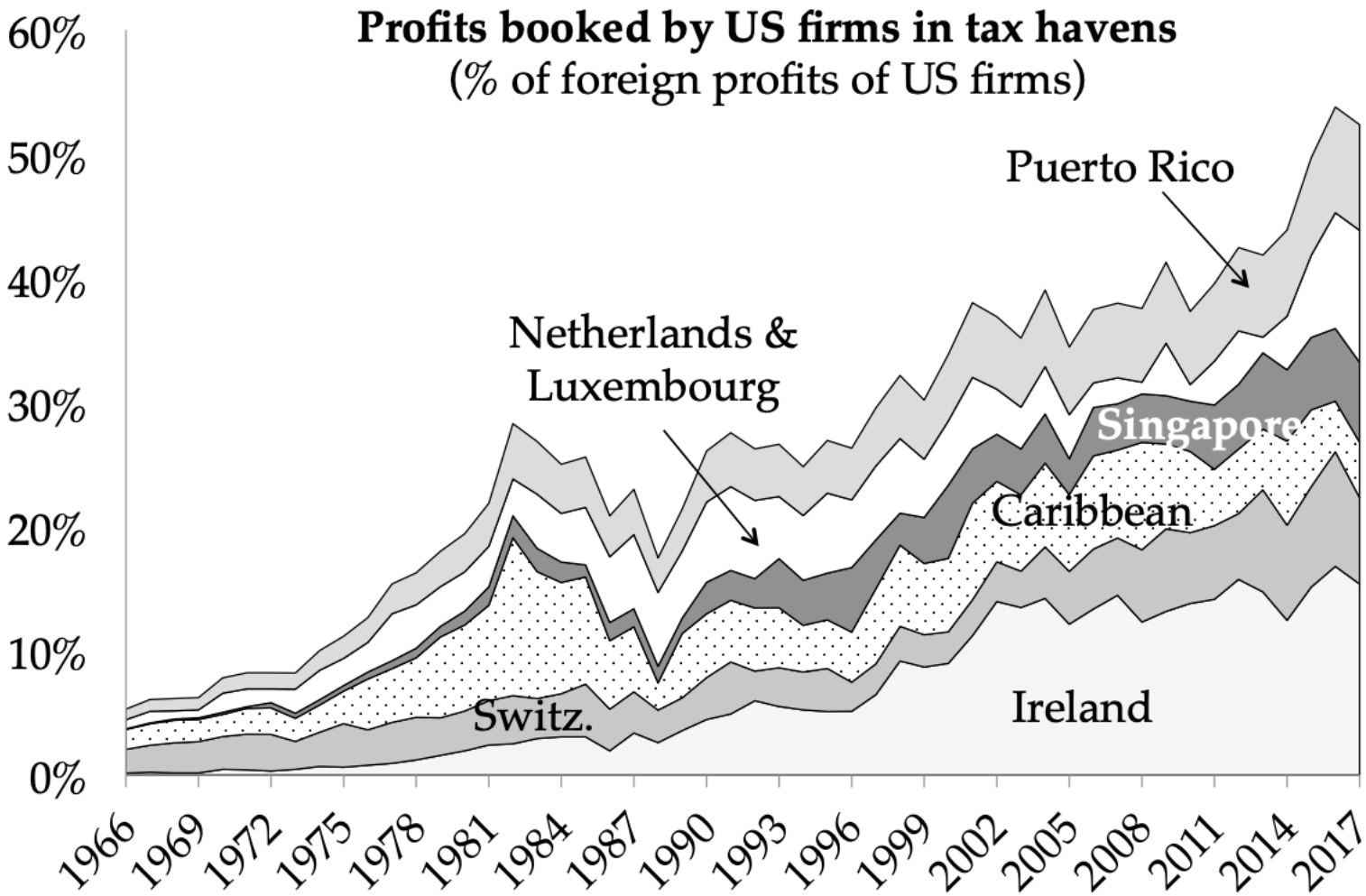
Tax havens are thriving



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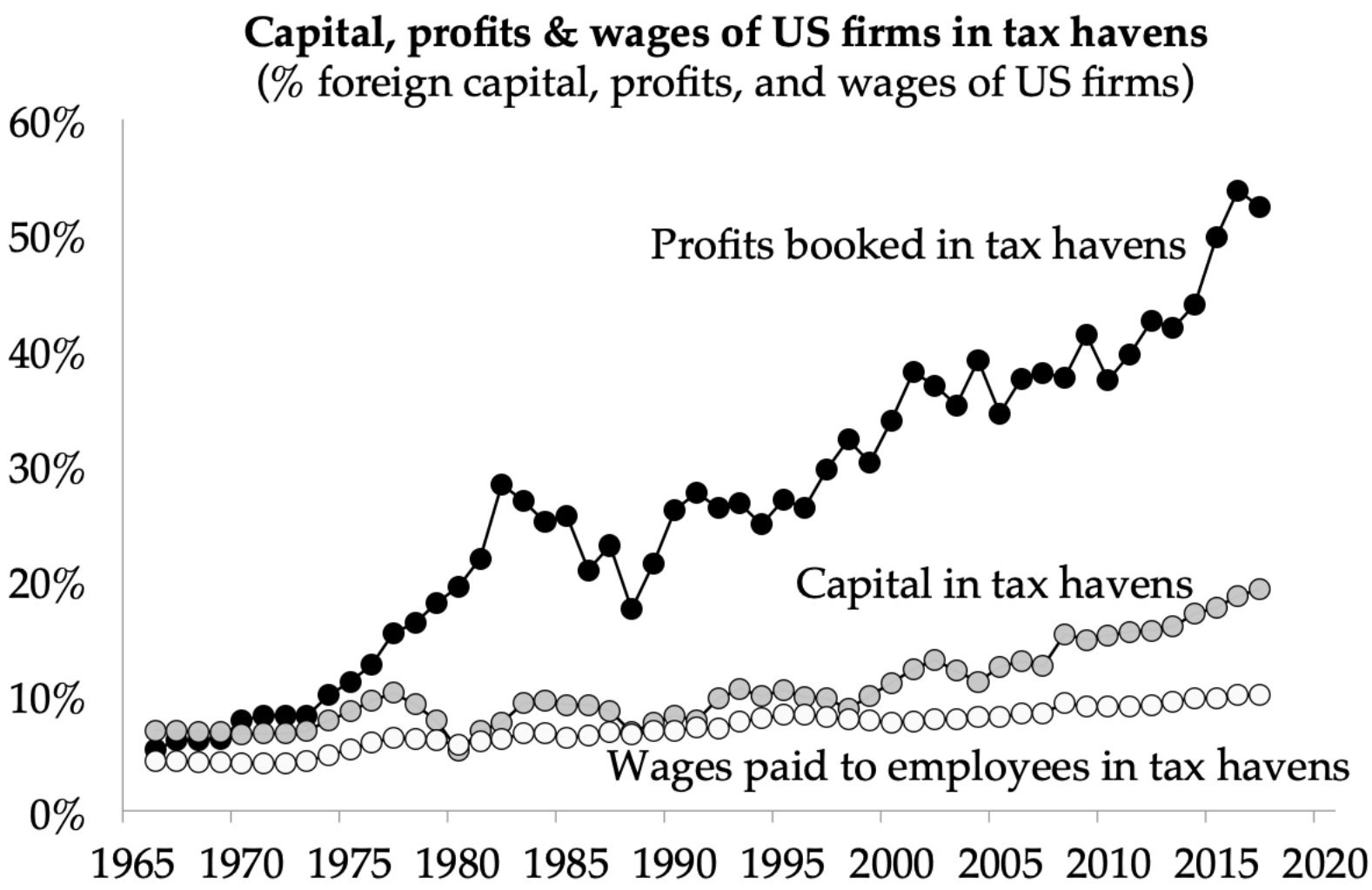

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Governments and the general public are outraged

"What is at stake is the **integrity** of the corporate tax" -*OECD*

"**All** firms '**big** or **small**, multinational or not, **should pay** their fair share of tax" – *Margrethe Vestager*

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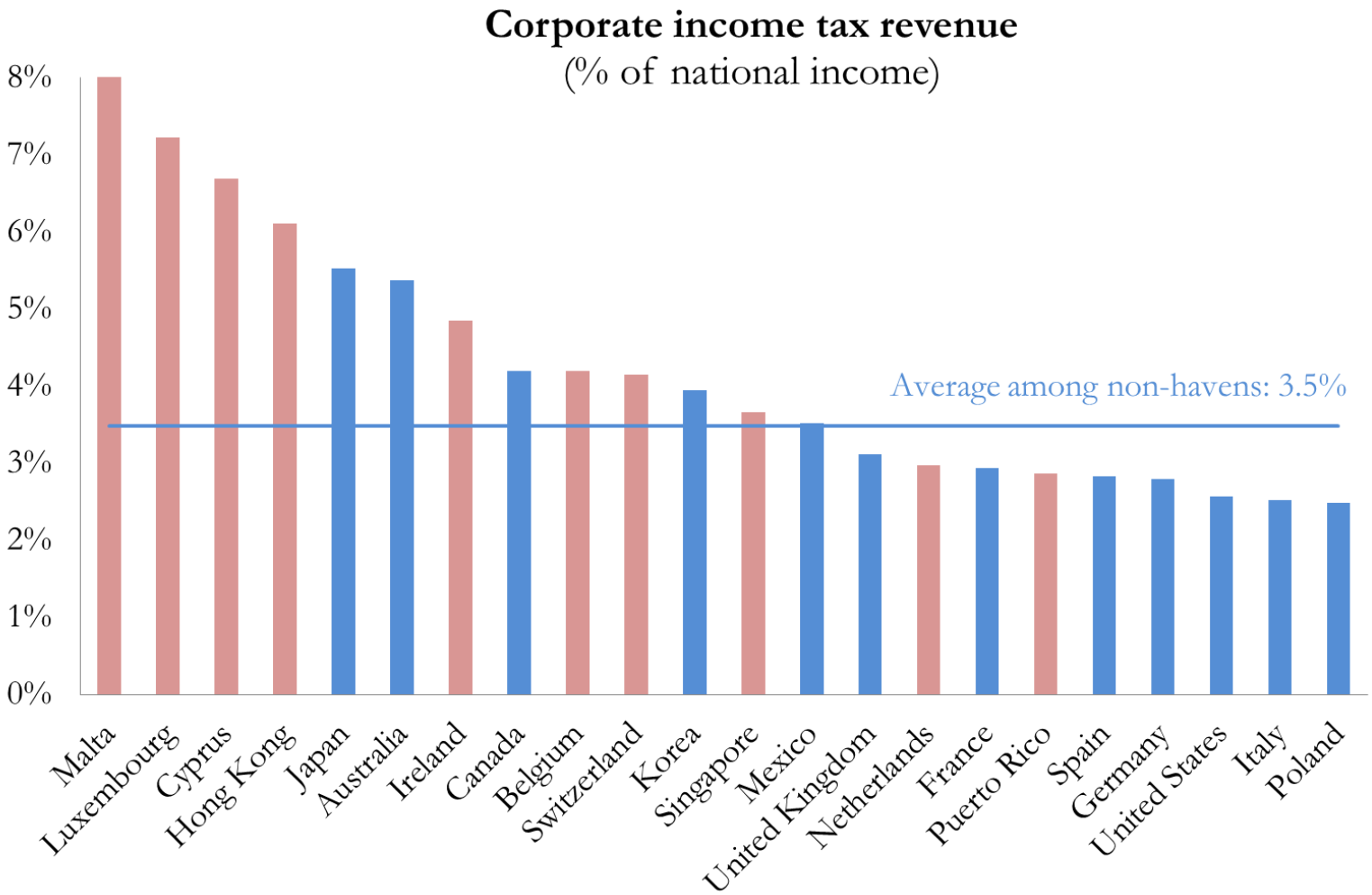
The biggest tax collectors are tax havens



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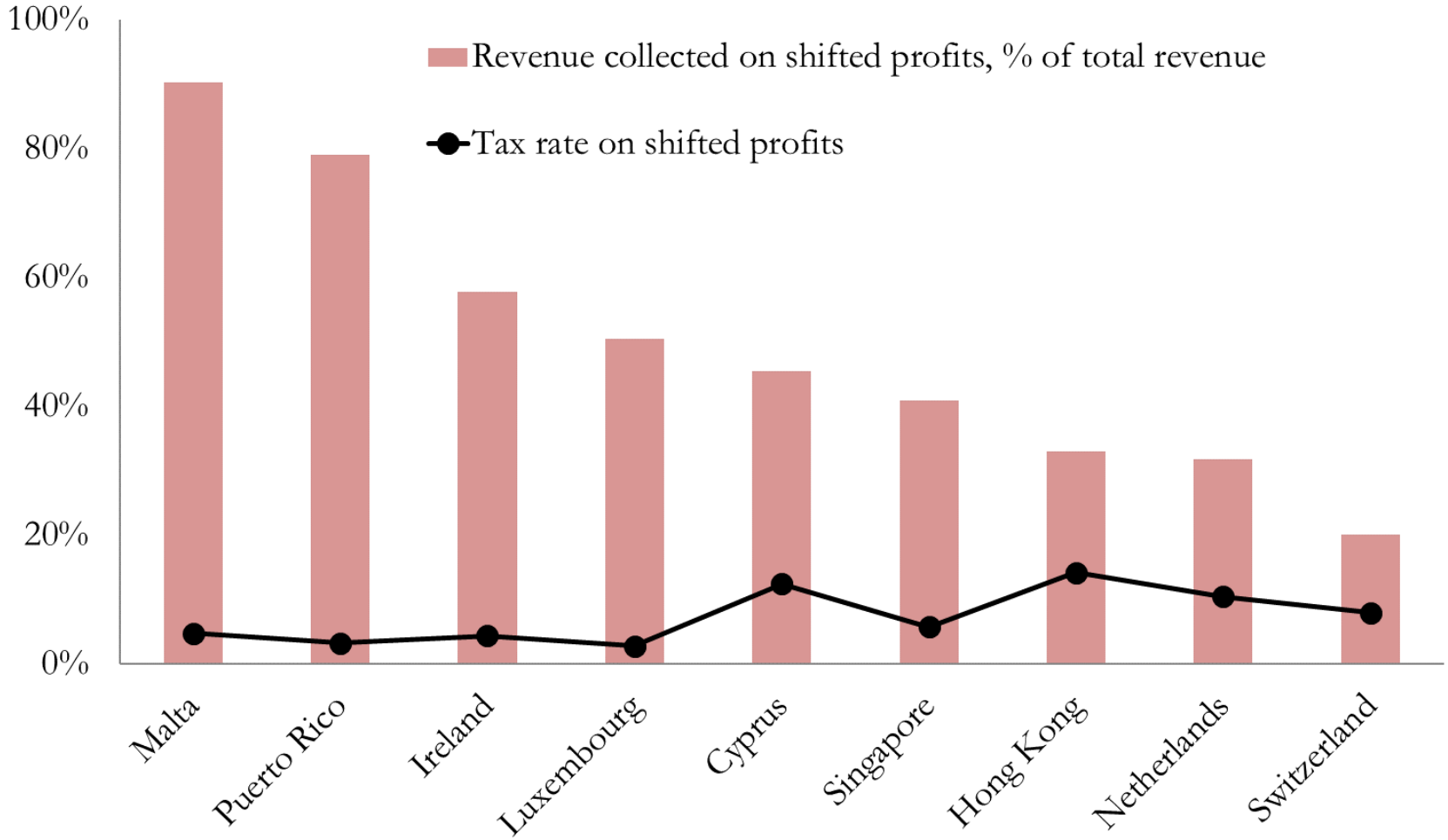
Corporate tax revenue collected & tax rate on shifted profits



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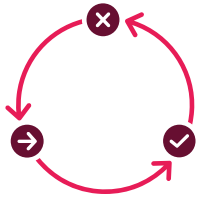
The big questions

How much is lost?



Who are the losers?

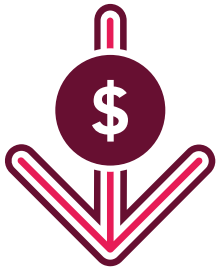
Why are we losing?

How can we fix this?

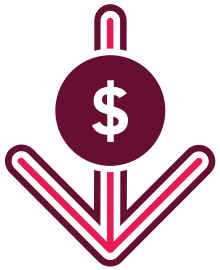
Are less developed countries more exposed to profit shifting?

Johannesen, Tørsløv & Wier 2019

Why is profit shifting relevant in a developing country setting?



Developing countries in dire need of tax revenue



Historically the corporate tax has been a key source of revenue

Lack the tools and capacity to combat profit shifting

Empirical strategy: How do firms respond to *foreign* tax cuts

Examining 200K firms over 10 years we ask the question: Following a tax cut in a foreign subsidiary, how aggressively do firms respond

Conclusion: Less developed countries *are* more exposed to profit shifting

We show that firms operating in developing countries respond more aggressively to tax incentives

E.g. following an opportunity to shift profits abroad the likelihood of reporting **zero** profits is **twice** as high in a developing country

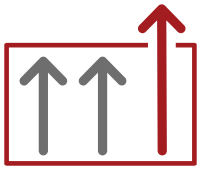
Big and Unprofitable: How 10% of Multinational Firms Do 98% of Profit Shifting

How does profit shifting relate to firm size?

Wier & Reynolds, 2018

Firm size and profit shifting matters

Relevant study to understand:



The competitive distortions of tax havens

Tax fairness

Empirical estimates

A few firms are VERY big – most are small

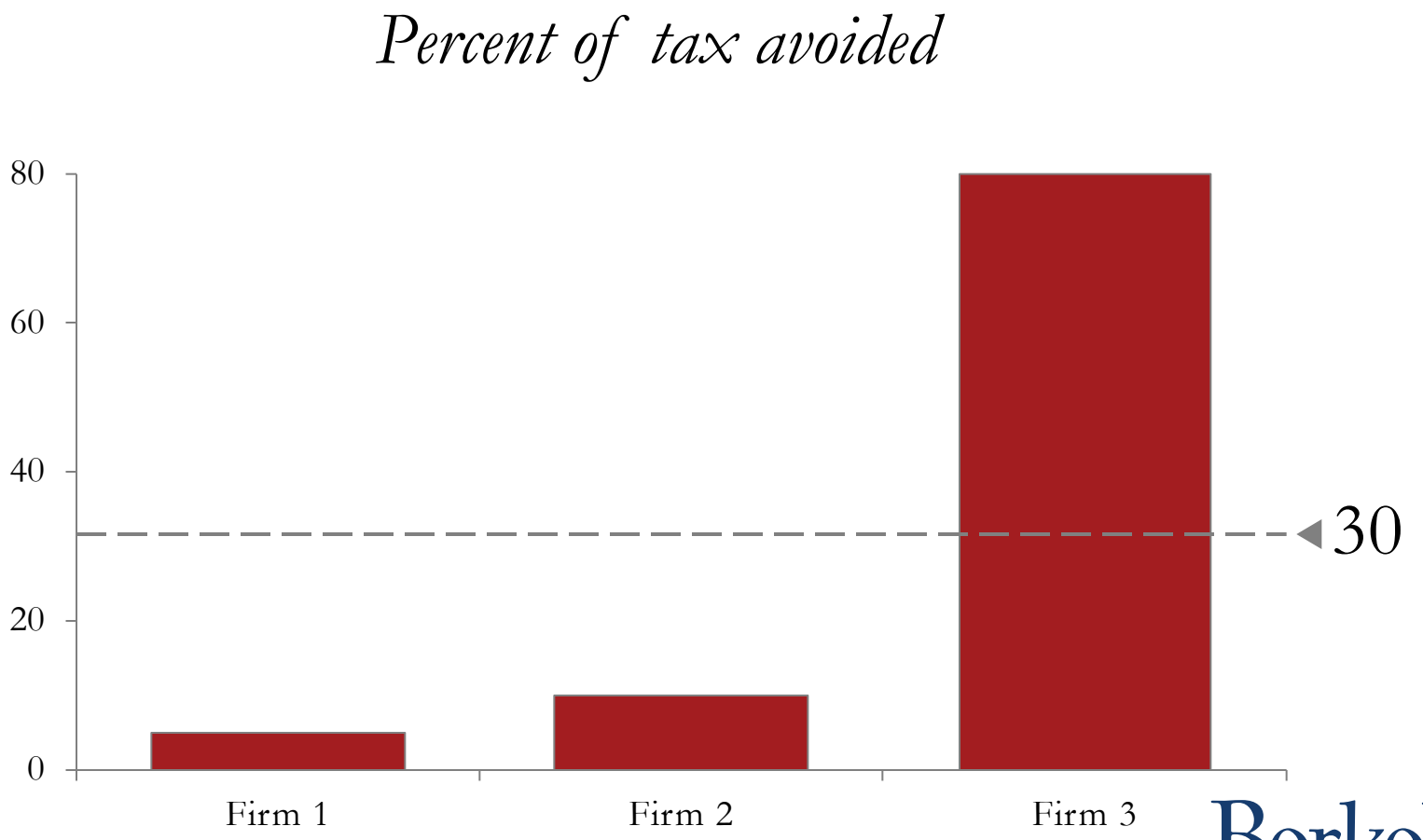
30%

30% of all profits accrue to 0.001% of all firms

80%

80% of all profits accrue to 10% of all *listed* firms

The impact of firm size on profit shifting estimates illustrated (1)



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The impact of firm size on profit shifting estimates illustrated (2)

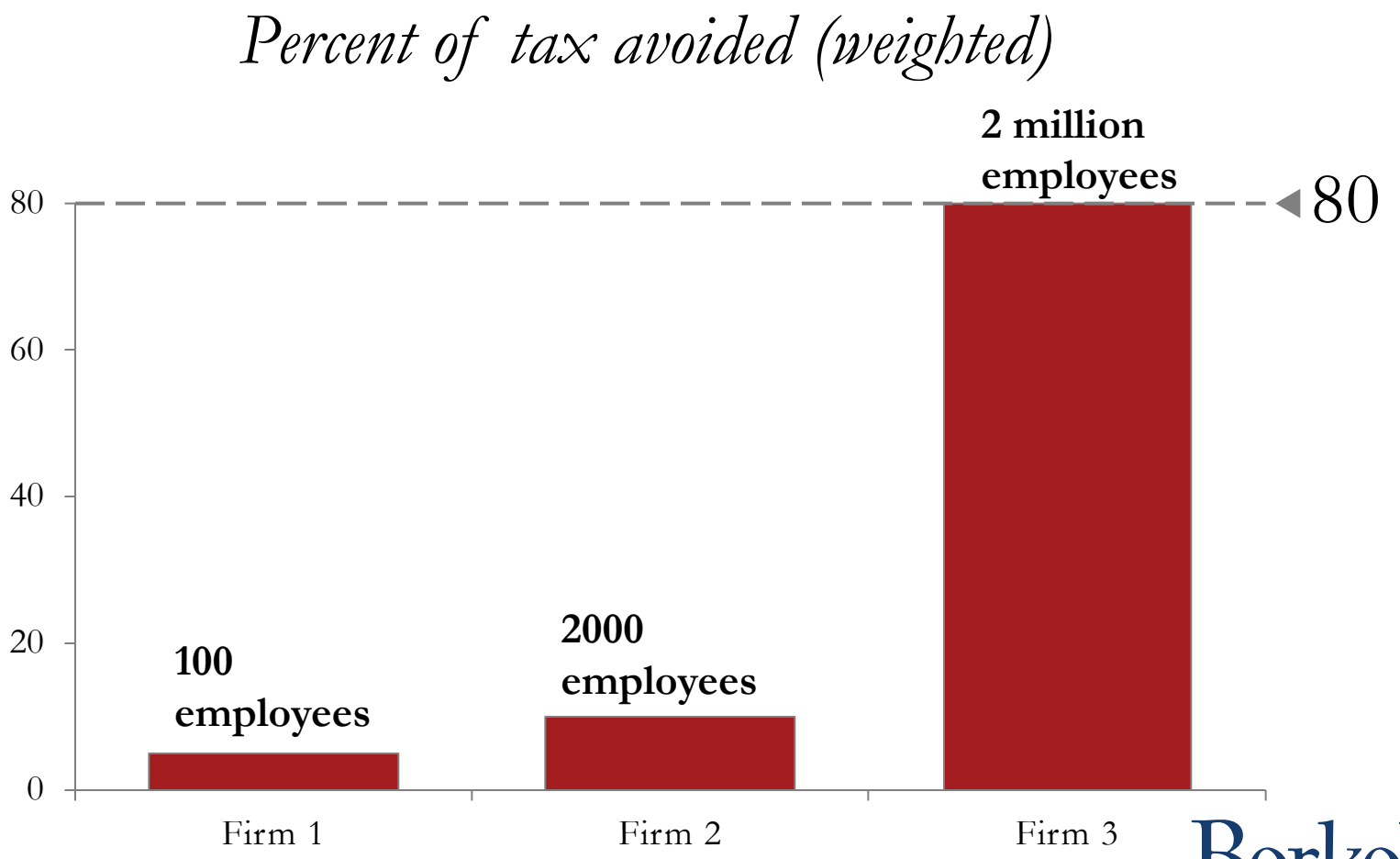

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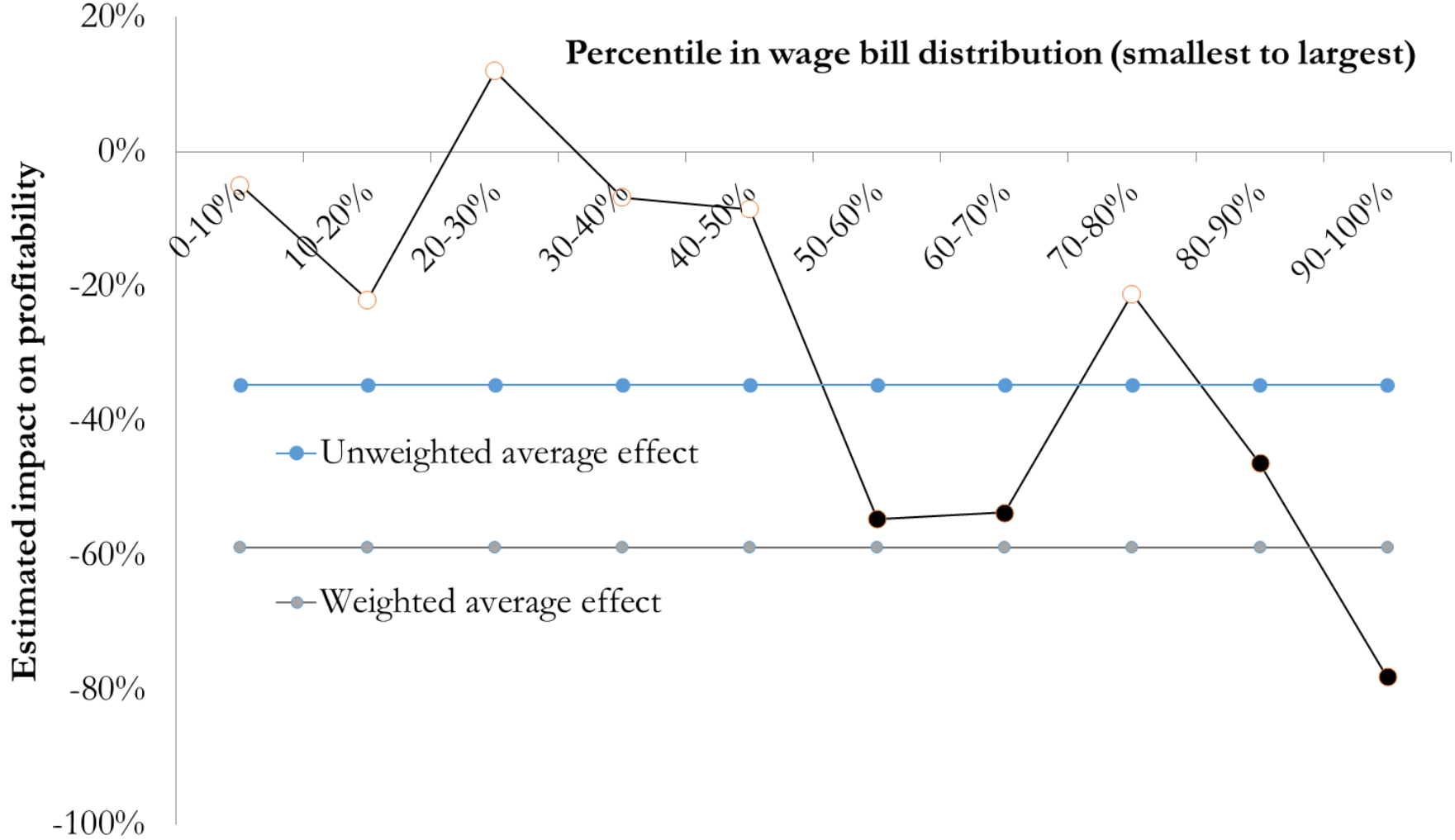
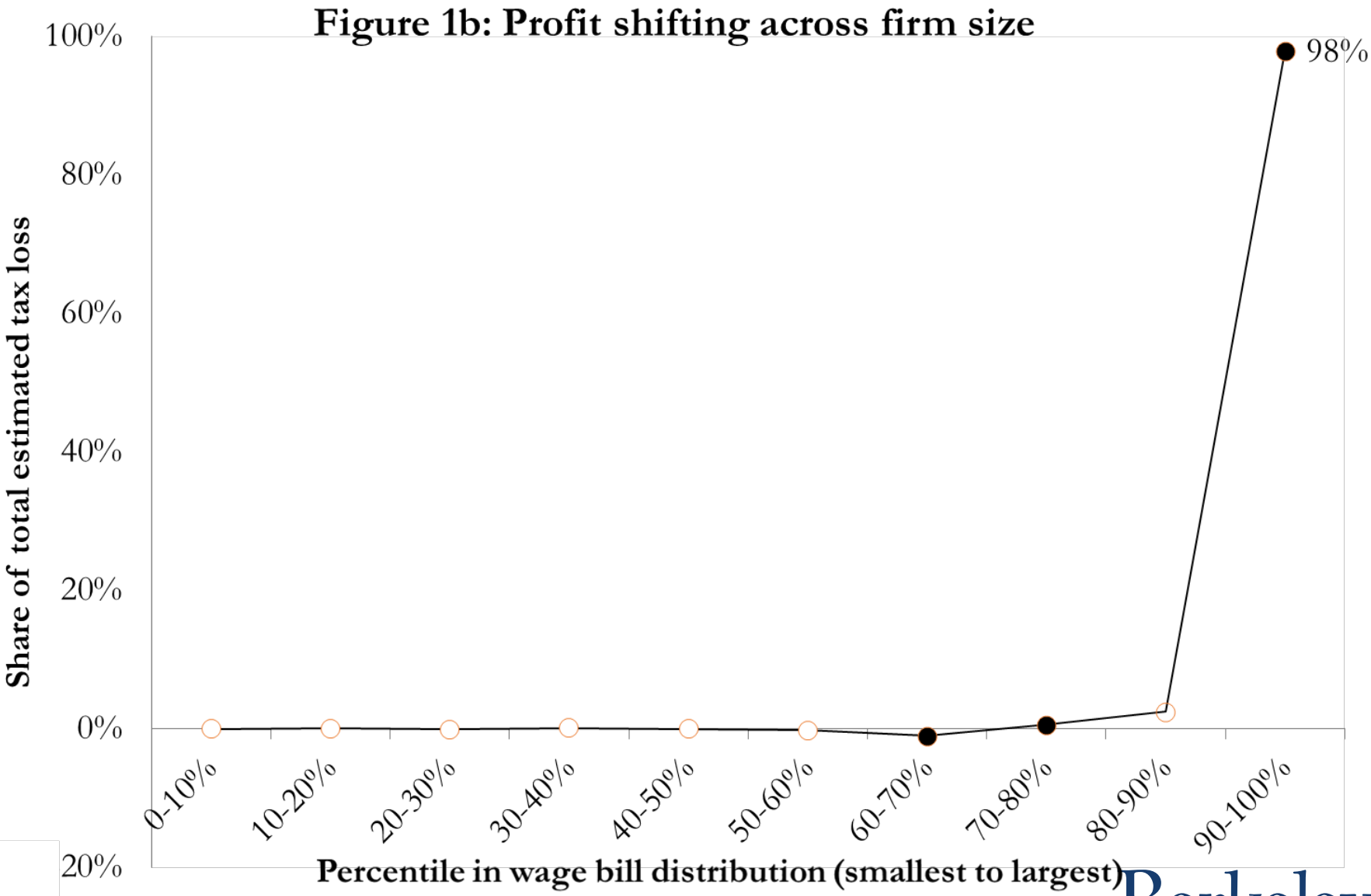
Figure 1a: Profit shifting across firm size





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The Missing Profits of Nations

Tørsløv, Wier & Zucman (2018)

Empirical part:

1. Global map of where profits are booked
2. Global map of profit shifting winners/loosers
3. Corrected national statistics

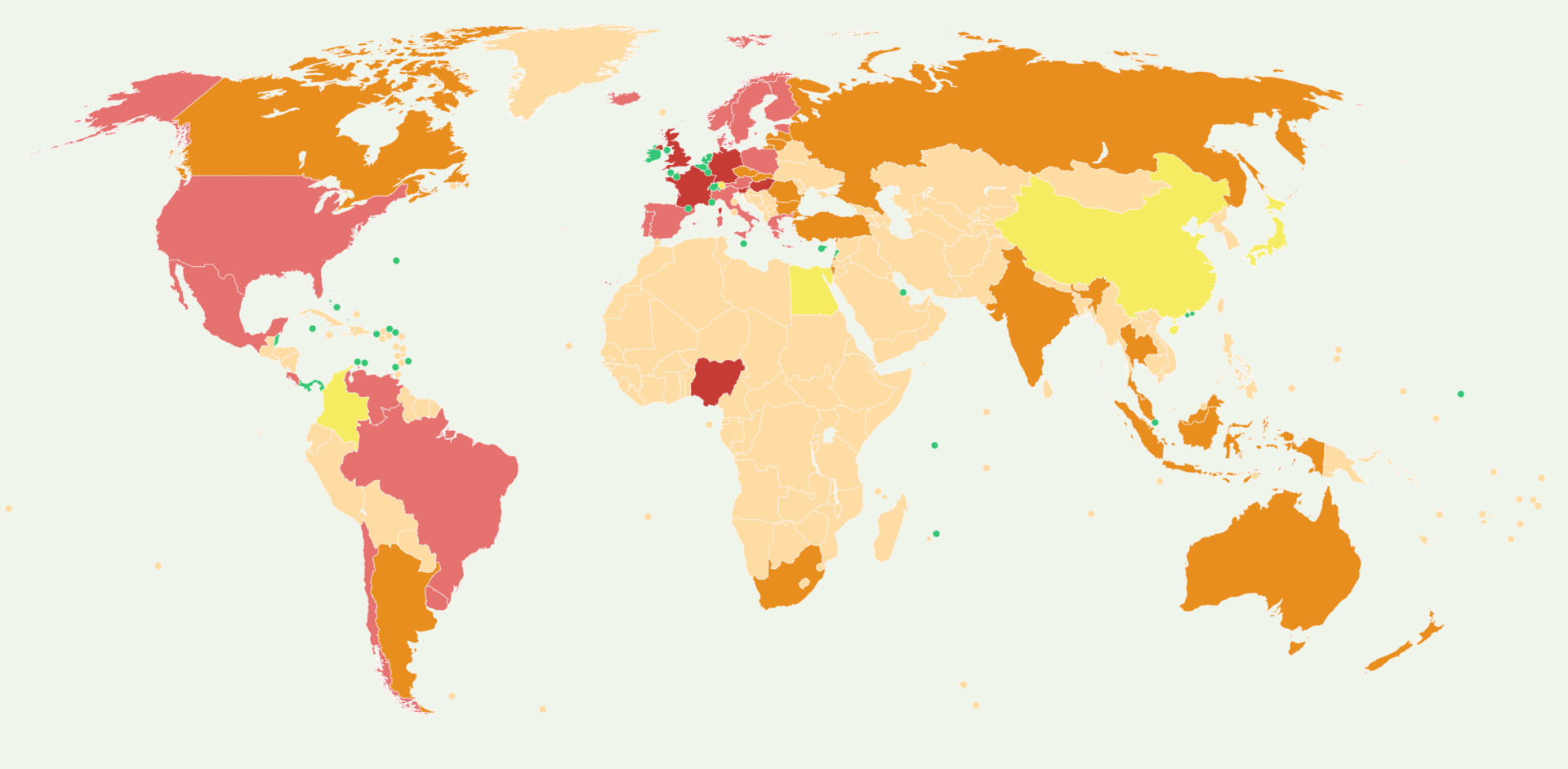
⇒ *Online database* *www.missingprofits.world*

Theoretical part:

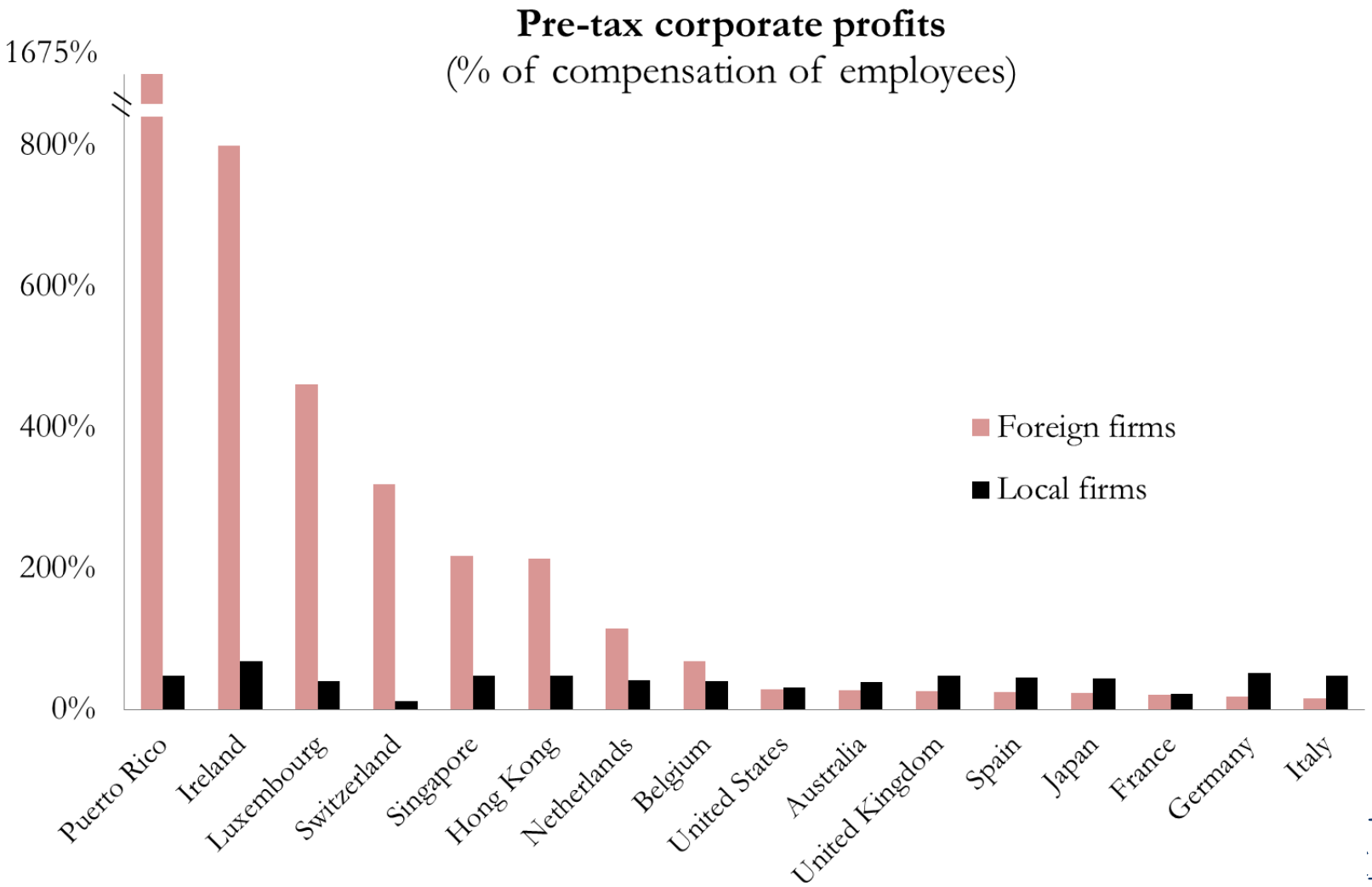
5. What policies are driving profit shifting?

How much is your country losing/winning?

- Check www.missingprofits.com



High profitability in tax havens is the result of enormous profitability in the foreign sector



Our results at a glance

- We find that about **40%** of multinational profits are artificially shifted to tax havens every year (=**$700bn**)
  - This is equivalent to **10%** of the world's corporate income tax receipts
- EU is the main loser, losing **20%** of its corporate tax base every year
  - Of this loss, **80%** goes to tax havens in the EU

25% of the US trade deficit is a fiction of profit shifting

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Remember: How is this possible?

International tax law cuts up multinational firms at country borders

Potential solutions

- The treaties of globalization are not set in stone. They can be rewritten: International agreement on 25% corporate minimum tax as pre-condition for further trade liberalization
- Putting taxes at the heart of future trade deals
- Defensive measures: sanctions for non-cooperative havens (approach followed successfully to force Swiss banks to cooperate) → Nothing inherent in globalization prevents high K taxation. Corporate tax could rise back to 50%.

The fundamental tax law

Summary

- The corporate tax is dying
- This has caused a marked mechanical decrease in the tax facing the very richest
- Profit shifting and country competition on tax rates are causing the demise of the corporate tax
- Fundamental reform to change this is possible

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