

Value Creation as the Fundamental Principle of the International Corporate Tax System

Michael Devereux and John Vella

Oxford University Centre for Business Taxation



Three Questions

- Where is corporate profit taxed?
- Where should corporate profit be taxed?
- Is the answer to either question: in the place in which value is created?

H.M. Treasury thinks so!

“1.1 The international tax framework is based on a principle that the profits of a business should be taxed in the countries in which it creates value.

1.2 The UK continues to support that position.”

H.M. Treasury: Corporate tax and the digital economy: position paper update

March 2018

Can we take a few steps back, please?

Why do we tax corporate profit?

- As a back-up to personal income tax?
- As a way of collecting a fair share from business for the provision of public goods and services?
- Because it could be an efficient (and not obviously unfair) way to raise revenue?
- Because voters don't understand about effective incidence?
 - And it may partly fall on foreigners?

Why tax corporate profit at all? (1)

1. Ability to pay: a proxy for personal income tax?

- ▣ Issues relating to
 - ▣ Tax exempt saving
 - ▣ Cross-border portfolio investment
- ▣ But, in any case, is unrelated to value creation

Why tax corporate profit at all? (2)

2. Payment for publicly-provided goods and services

- But is value and/or cost related to profit?
 - Why not a user charge?
- If profit depends on access to publicly-provided goods and services, then this must be true in many countries, including eg. place of customer

How does the existing tax system work?

OECD Model tax convention

- Based on “1920s compromise” of allocation of rights to tax international business income:
- **Active** business profits are taxed in the “**source**” country (Article 7)
- **Passive** income is taxed in the “**residence**” country
 - Dividends (Article 10)
 - Interest (Article 11)
 - Royalties (Article 12)

Does “source” equal place of value creation?

- Useful in BEPS project for identifying tax havens as places where there is no value creation

BUT - What about (for example):

- Inter-company debt?
- Allocation of risk to risk controller?
- Changes in demand in market country

Are digital businesses different?

Is value created from

- Personal information from a Google search?
- Contribution to network effects on Ebay?
- Deliberately attracting new users by posting content on Facebook?
- And should this be taxable in the country of the user?

A non-digital analogy: Is it coming home?

- ▶ Nike (allegedly) pays workers in Bangladesh 21 pence an hour to produce the England football kit
 - ▶ It sells the kit in England for £160
- ▶ UK minimum wage in UK is £7.83
 - ▶ So does Nike create value of £7.62 per hour in Bangladesh?
- ▶ Probably need to identify price of kit when it leaves Bangladesh:
 - ▶ ALP of sales to Germany is quite low
 - ▶ Nike have presumably paid the FA for rights to sell the “official” shirt
 - ▶ Who owns those rights?

It's coming home



So is “value creation” really a solid basis for claiming taxing rights?

▀ Vague concept

Applying it

- ▀ ... generates great complexity
- ▀ ... and probably adds to economic distortion as businesses seek to move value creation to low tax countries

Concluding thoughts

- Is corporate profit taxed in the place of value creation?
- Should corporate profit taxed in the place of value creation?
- Will the notion of value creation help solve the problems of the international tax system?
- No
- No
- No – it is likely to make it more difficult