Multinational firms, intellectual property and corporate income taxes

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Public concern that corporations aren’t paying a “fair share” of tax

- The media in the US and UK has called for companies to pay more tax and has reported heavily on the strategies that companies employee to avoid tax
  - Bloomberg “The Great Corporate Tax Dodge”
  - The New York Times “But Nobody Pays That” (for which the author received the Pulitzer prize)
  - The Times “Secrets of Tax Avoiders”
  - The Guardian “Tax Gap”
In 2012 Starbucks became a target for public protests.
Starbucks tax bill in the UK

- Starbucks had paid very little corporate income tax since it entered the UK market in 1998
- Starbucks declared zero profits (and therefore zero tax payments) in most years in the UK
### It's not just Starbucks

#### OH YES, THEY’RE THE GREAT AVOIDERS

<table>
<thead>
<tr>
<th>Company</th>
<th>Revenues*</th>
<th>Tax Paid</th>
<th>Rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>Starbucks</td>
<td>£398m</td>
<td>Zero</td>
<td>Zero</td>
</tr>
<tr>
<td>Amazon</td>
<td>£3.3bn</td>
<td>£1.8m</td>
<td>0.0545pc</td>
</tr>
<tr>
<td>Apple</td>
<td>£10bn (est)</td>
<td>£11.4m</td>
<td>0.114pc</td>
</tr>
<tr>
<td>Facebook</td>
<td>£175m (est)</td>
<td>£238,000</td>
<td>0.136pc</td>
</tr>
<tr>
<td>Google</td>
<td>£2.6bn</td>
<td>£6m</td>
<td>0.23pc</td>
</tr>
<tr>
<td>EADS</td>
<td>£3bn</td>
<td>£10.5m</td>
<td>0.35pc</td>
</tr>
<tr>
<td>IBM</td>
<td>£3.8bn</td>
<td>£21.7m</td>
<td>0.57pc</td>
</tr>
</tbody>
</table>

| UK Tax Gap: | £32bn | Corporation Tax Gap: | £4.1bn |

*latest figures available

Sources: HMRC, company accounts, analyst estimates and forecasts.
Base Erosion and Profit Shifting (BEPS)

- Increasingly cross border nature of economic activity
  - creates opportunities for tax avoidance

- Some firms use the rules to avoid corporate income taxes
  - Apple has an Irish subsidiary, no employees (until last year)
    - this subsidiary has rights to Apple’s intellectual property outside of the US
    - it receives 60% of Apple’s worldwide sales outside the US
  - Ireland’s tax rules means that that the firms should be taxed in the US
  - The US tax rules mean that the firm should be taxed in Ireland
  - So the firm is not taxed (on approx $ 10bn a year)
Policy concern

- Policy makers have also expressed concern that corporations aren’t paying a “fair share” of tax
  - “companies need to wake up and smell the coffee”
    David Cameron at the World Economics Forum 2013

- OECD *Base Erosion and Profit Shifting (BEPS)* report
  - concerned with opportunities for MNEs to greatly minimise their tax burden

- BUT
  - not clear that BEPS actually that important
  - the real issue is about where firms pay tax
  - not clear there is real political support for BEPS
  - the proposed reforms provide a patch rather than tackling the structural issues
This talk

• Quick reminder about some principles of corporate tax
  • who bears the burden of the corporate income tax?
  • why tax corporate income?

• Recent trends
  • corporate income tax rates have fallen
  • but revenues have not
  • corporate profits have increased

• What are we taxing, and where should these revenues be paid?
  • more systemic problems around intangible assets

• What are the problems with the international taxation of corporate income, and does BEPS address them?
Who bears the burden of the corporate income tax?

- **Legal incidence**
  - legally “the firm” pays the tax

- **Economic incidence:**
  - who is made worse off because of the tax
  - firms can not bear the economic incidence of a tax, they can not be made worse off, only people can

- Who is potentially made worse off by the corporate tax?
  - Shareholders, if the impact of tax is to reduced dividend or reduce capital gains
  - Workers, if the impact of tax is to reduce wages
  - Consumers, if the impact of tax is to increase prices

- Economic incidence can be very different from legal incidence
Why tax corporate income?

- Why have a corporate income tax
  - shareholders pay income tax on dividends
  - if we want to tax this income higher, raise income taxes
  - or increase consumption taxes

- Corporate income taxes might play an important role as a backstop to labour income taxes
  - In 2002 the UK government reduced the rate of corporate income tax on small firms from 10\% to 0\%
    - they lost something like £1bn in tax revenue a very short time
    - taxi drivers and other self-employed people incorporated and become firms
Who bears the burden of the corporate income tax?

- Shareholders might not bear the full economic incidence of corporate incomes taxes
- One reason - capital is more mobile than workers
  - A firm can move its investment to another country, most people won’t move to another country to work
  - If corporate income taxes are high in one country then a firm will move to a country with lower taxes
  - This means workers have less capital to work with
  - This reduces their marginal product (they produce less in each hour that they work)
  - This lowers their wages
  - Meaning that some of the economic incidence of the tax has been shifted to workers
Competition for capital

- The idea that capital is mobile leads to the prediction that governments should compete for firms to invest in their country by lowering their corporate income tax rates.
- Over the past 30 years governments have reduced corporate income tax rates substantially.
Governments have reduced corporate income tax rates

 Corp inc tax rate

![Bar chart comparing corporate income tax rates for the US, France, Germany, UK, Australia, and OECD average in 1980 and 2013.](chart.png)

- **US**: 1980 - 40%, 2013 - 30%
- **France**: 1980 - 50%, 2013 - 40%
- **Germany**: 1980 - 60%, 2013 - 50%
- **UK**: 1980 - 50%, 2013 - 30%
- **Australia**: 1980 - 40%, 2013 - 30%
- **OECD average**: 1980 - 50%, 2013 - 40%
And offered preferential rates to income from intellectual property

- Reduced rate of corporate income tax for “income from patents”

<table>
<thead>
<tr>
<th>Country</th>
<th>Preferential rate</th>
<th>Main rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>Netherlands</td>
<td>5</td>
<td>25</td>
</tr>
<tr>
<td>Luxembourg</td>
<td>5.8</td>
<td>29</td>
</tr>
<tr>
<td>Belgium</td>
<td>6.8</td>
<td>34</td>
</tr>
<tr>
<td>UK</td>
<td>10</td>
<td>23</td>
</tr>
</tbody>
</table>
• Statutory tax rates have fallen substantially
• Has revenue from corporate income tax declined?
Corporate income taxes as a share of total tax revenue

% total tax revenue

Source: OECD
Corporate income taxes as a share of GDP

Source: OECD
Why have revenues stayed buoyant when corporate income tax rates have fallen?

- Despite the long running concerns and the claims that companies do not pay enough tax, revenues from corporate income taxes have been surprisingly buoyant.
- This is mainly because corporate profits have increased as a share of GDP.
  - Share of activity that is in corporations has increased.
  - Profitability of corporations has increased.
Why the increase in taxable profits?

• One likely important reason: economic activity increasingly arising from intangible assets
  • exploited simultaneously in multiple locations
  • riskier? meaning normal required rate of return is higher
  • more reliant on equity? not treated as favourably as debt
  • use entrepreneurial inputs (labour/owners)? shifting earnings from labour to capital

• Other potential factors
  • more market power
  • shift into corporate sector
  • others?
Why doesn’t Starbucks pay tax in the UK?

- the UK subsidiary makes royalty payments to another Starbucks subsidiary in the Netherlands
- the payment is for use of the brand and other intellectual property
- the subsidiary in the Netherlands pays tax
How much tax does Starbucks pay?

- In 2011 Starbucks paid 31% tax rate worldwide
  - but paid 13% on its overseas activities

- Where did the profits arise?
  - when I buy a cappuccino in Starbucks what am I paying for?
    - the machines?
  - the fact they ask my name and write it on the cup, the music they play, that they give me the free iTunes download?
  - those things were “created” at headquarters in the US, not in the UK branch

- It is difficult to know what is the “market” price of these intangible assets, as they are not traded on the market
Where should a firm pay tax?

- In the 1980s, governments were concerned that large corporations paid **too much tax**, because they faced tax on their activities in several countries.

- International agreement at the OECD that:
  - firms should pay tax in the location that the profit arose
  - individuals should pay tax in the location that they reside

- BEPS report (Addressing Base Erosion and Profit Shifting):
  - now the concern is that firms might pay too little tax
    - do they really, or is it just that they don’t pay it where (some) governments want them to
  - BEPS seeks to assert the principle that firms pay tax in the location of value creation
    - but with value creation largely derived from intangible assets, location is not well defined
Final comments

• It’s not just firms that are using the rules to reduce tax
  • Governments want to:
    • lower tax in their country to attract real investment
    • lower tax on “their” firms to generate competitive advantage when they compete abroad
  • Yet (some) also want to tax corporate revenue
  • and it may be difficult to do this unilaterally

• BEPS is a piecemeal approach to structural problems
  • with over 60% of world trade occurring within firms, and increasingly based on intangible assets, makes it difficult to allocate taxable profits across countries