Econ 101: Taxing Multinational Corporations

March 28, 2025

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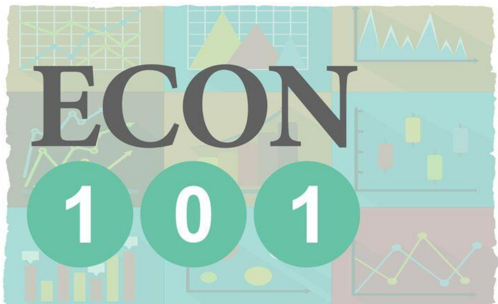

Econ 101: Understanding Business Taxes

March 7: Pass-Through Firms (recap; slides)
Today: Multinational Corporations

Overall Objective: You will leave with the knowledge and confidence you need to make sense of business taxation and advise your bosses in this year's high-stakes debate.

Previous Briefings:

- September 27, 2024: Understanding Tax Policy (recap; slides)
- October 18, 2024: The Promise of Equitable and Pro-Growth Tax Reform (recap; slides)

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Outline For Today

Focus will be on how global tax deal would help address long-standing – and growing – corporate tax challenges

- Corporate Tax Basics
  - How are they taxed?
  - How much revenue is raised?
  - Who pays?
- Multinational Corporate Tax
  - Norms & principles
  - Tax competition: Race to the bottom
  - International cooperation: Global tax deal
- Q & A

How are they taxed?

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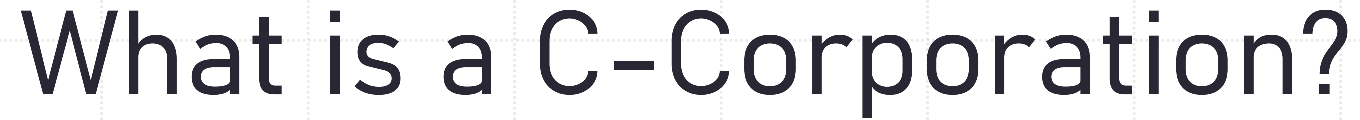

What is a C-Corporation?

- All public companies are C-corps, but not all C-corps are public companies
  - Examples: Apple, AT&T, Chevron, Eli Lilly, Microsoft, Visa, Walmart
- Two levels of tax:
  - **Entity level (21%)**
  - Shareholder level (qualified dividend/long-term capital gain: 0, 15, 20%)
    - But only 27% of U.S. equity is held in taxable accounts (Rosenthal and Mucciolo 2024)

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What is the Corporate Income Tax?

- Tax imposed on the taxable profits of corporations

$$Tax\ Bill = (Taxable\ Income\ - Deductions) \times 21\%\ - Credits$$

- Deductions include:
  - Input costs, wages, interest, depreciation of capital, prior year taxable losses, state and local taxes
- Credits include:
  - General Business Credits (R&D, Low-Income Housing, Energy Production)
  - **Credit for foreign taxes paid on foreign-source income**

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Corporations Frequently Pay No Tax

Figure 2: Percentage of Corporations That Reported No Federal Income Tax Liability after Credits, 2014 to 2018

Percentage of corporations
100%
90
80
70
60
50
40
30
20
10
0
2014 2015 2016 2017 2018
Tax year

All active corporations
Corporations that filed Schedule M-3
Profitable large corporations

Source: GAO analysis of Internal Revenue Service (IRS) data. | GAO-23-105384

- 70% of all active corporations pay no tax in any given year
- 50-60% of large corporations pay no tax
- 20-30% of profitable large corporations pay no tax

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What is an Effective Tax Rate?

$$\text{ETR} = \frac{\text{Taxes Paid}}{\text{Profit}}$$

- While it is easy to measure taxes paid, what do we mean by profit?
  - Taxable profit?
  - Book profit (financial statements)?
  - What about firms that are unprofitable, should they be part of calculations of average ETRs?
- Average ETRs are generally less than the statutory rate
  - 2018 AETR of Profitable Large Corporations: 9%
  - 2017 AETR of Profitable Large Corporations: 11-16%

Rule of thumb: AETR is roughly ½ of the statutory rate

How much revenue is raised?

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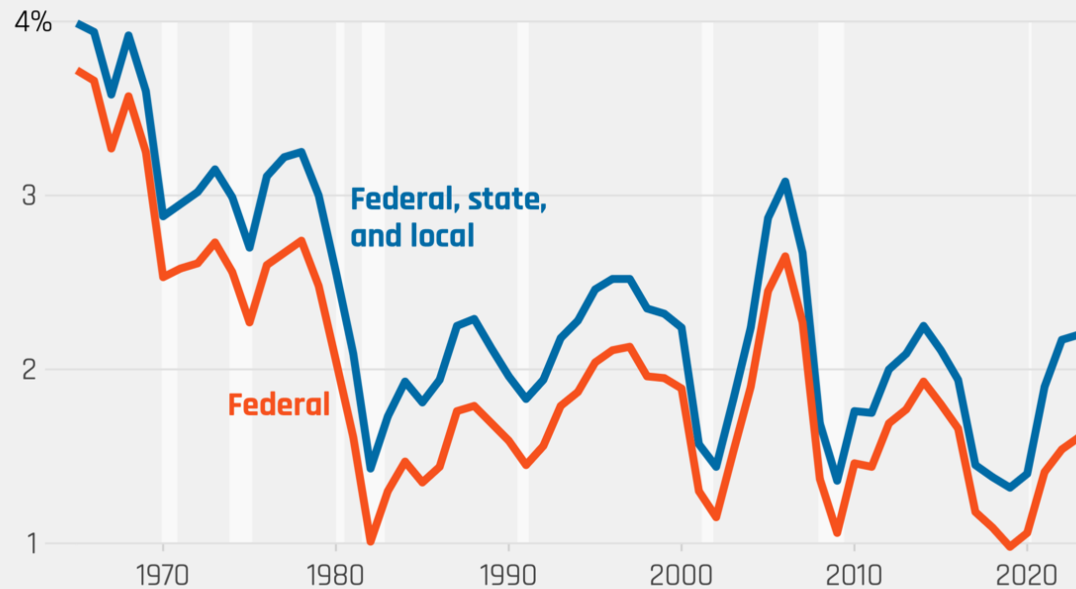
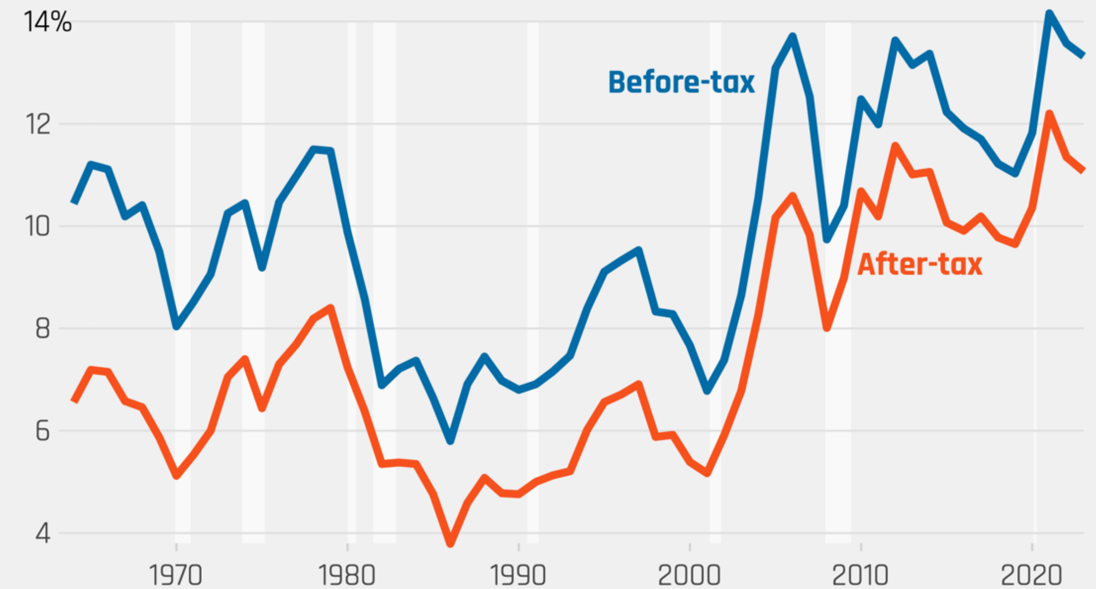
Corporate Tax Account for 11% of Total Tax Receipts

- FY 2023 Tax Receipts: $4,919B
  - Corp Tax: $530B (11%)
    - Was 35% in 1945!
  - Individual Tax: $2,416B (50%)
    - Don't forget! Pass-through businesses pay individual tax

Recent revenue trend is flat, while profits are up





Who pays?

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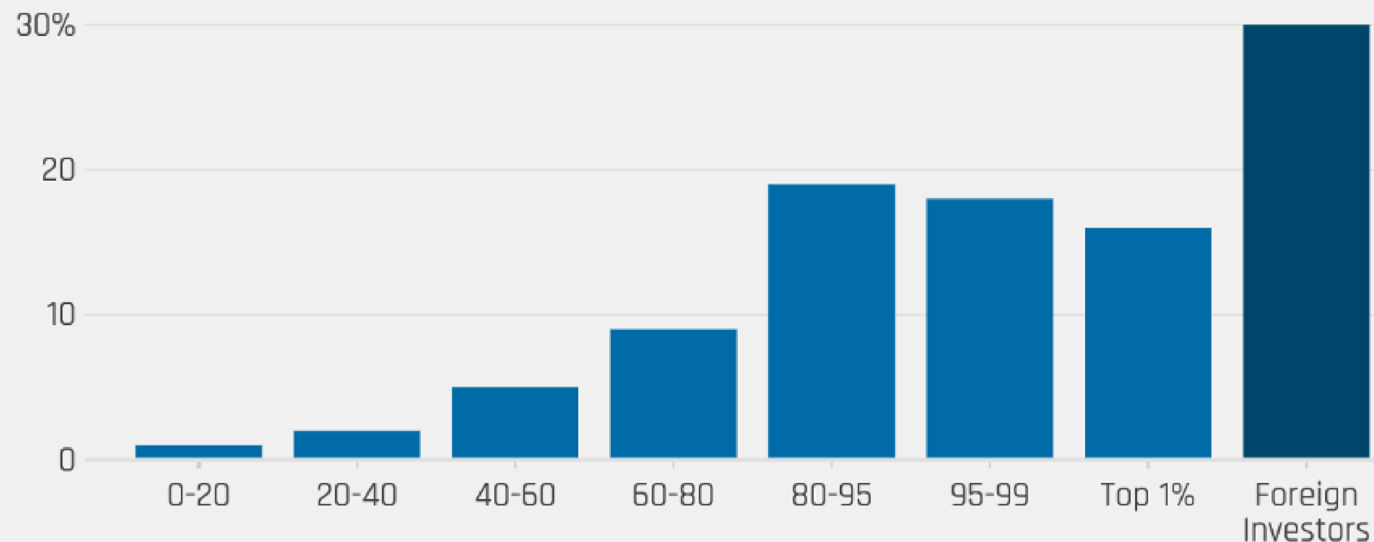
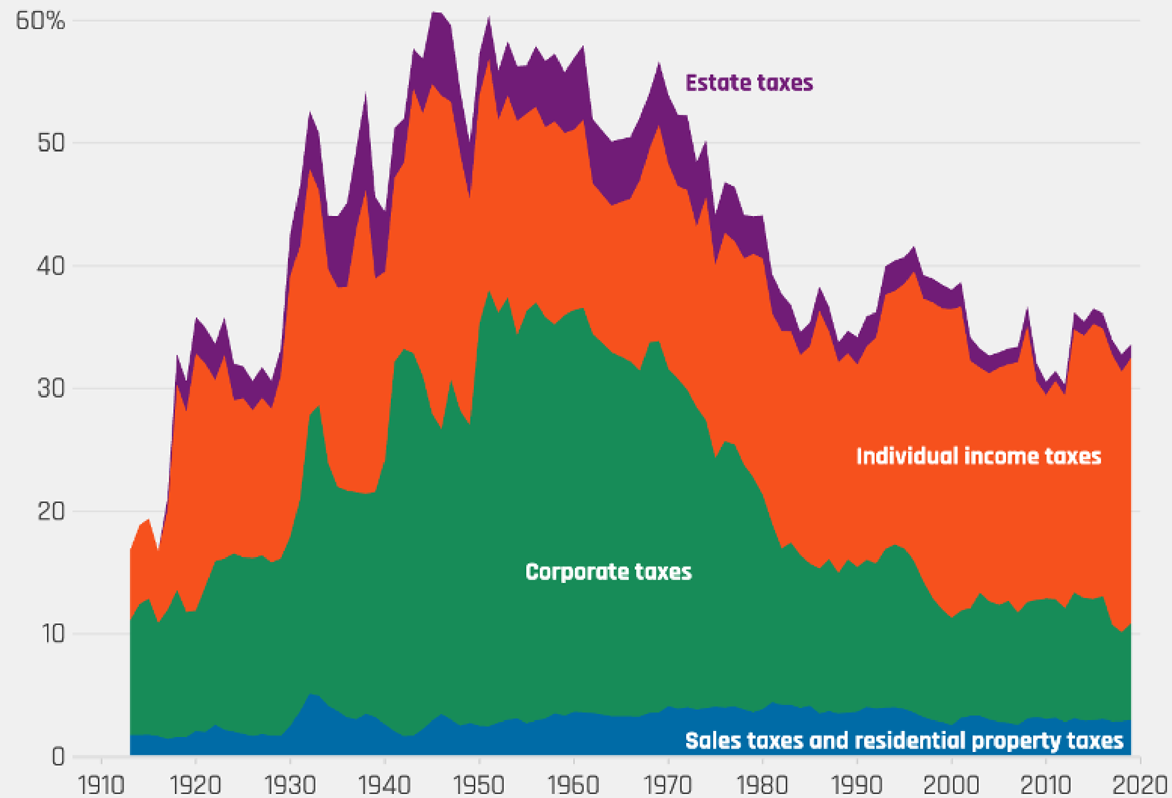
Who pays?

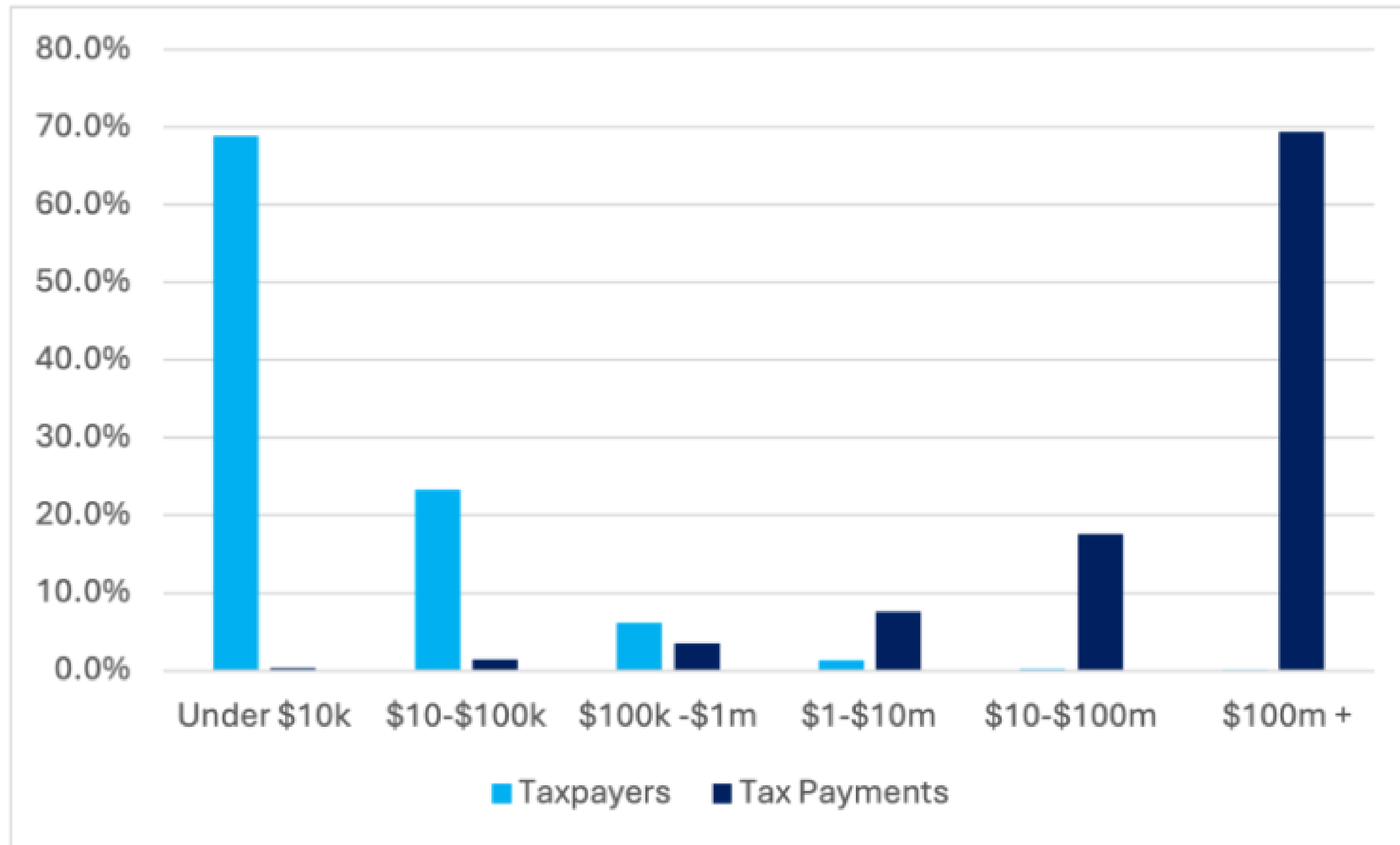


- Academic evidence:
  - **Short-term:** Almost entirely borne by shareholders
  - **Long-term:** 75-25 split between shareholders and workers (CBO/JCT); 82-18 (Treasury)

Implications for inequality

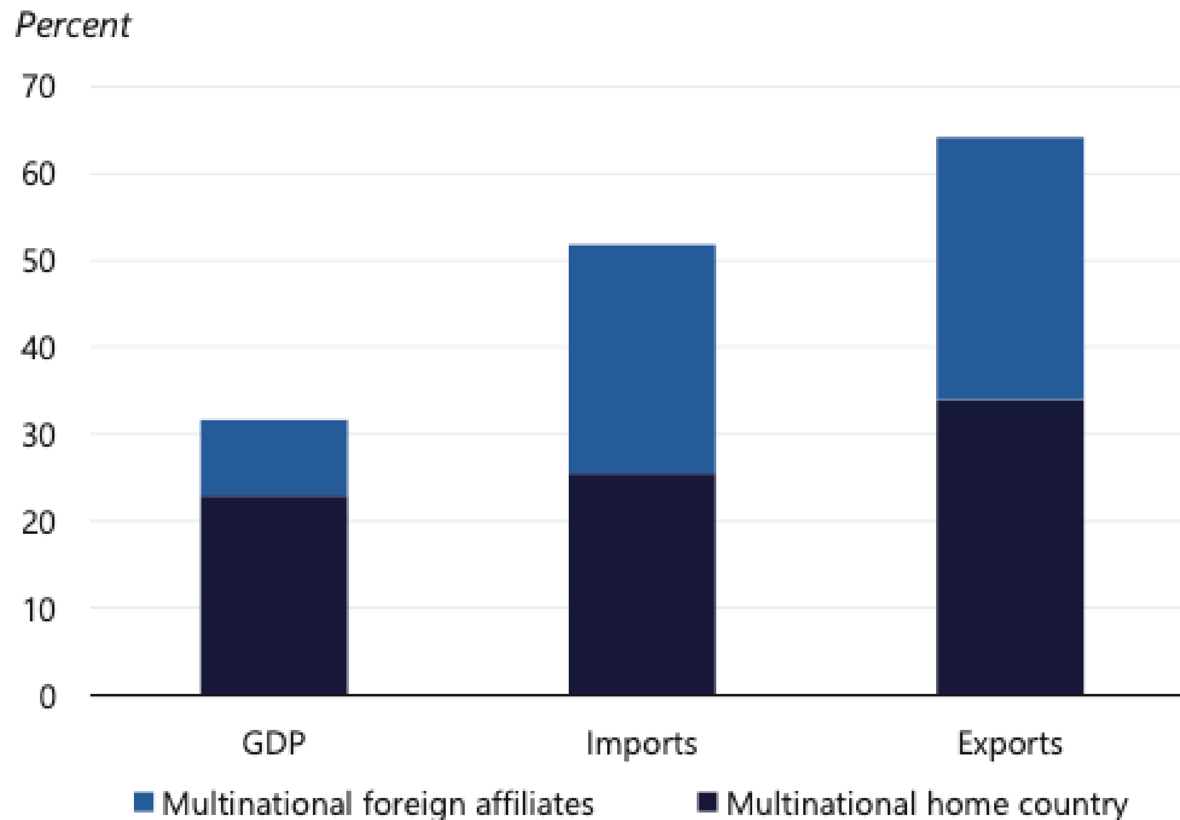


Most corporate tax revenue paid by just a few firms



Credit: Source: IRS, Department of the Treasury, Pub. 16, "Statistics of Income – 2019 Corporation Income Tax Returns Complete Report," available at https://www.irs.gov/pub/irs-pdf/p16.pdf. See Table 4.

Rise of multinationals



- Multinationals:
  - 30% of Global GDP
  - 50% of Global Imports
  - 65% of Global Exports

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Norms & principles

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Norms of International Income Tax

1. First right to taxation belongs to the country in which a corporation’s assets are located

2. Income should not be subject to double taxation (multiple countries taxing the same income)

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Digitization Raises Questions About Right to First Taxation

- First right to taxation: country in which a corporation's physical assets are located

- Country has right to tax part of income if a corporation has a physical presence
  - *Nexus*

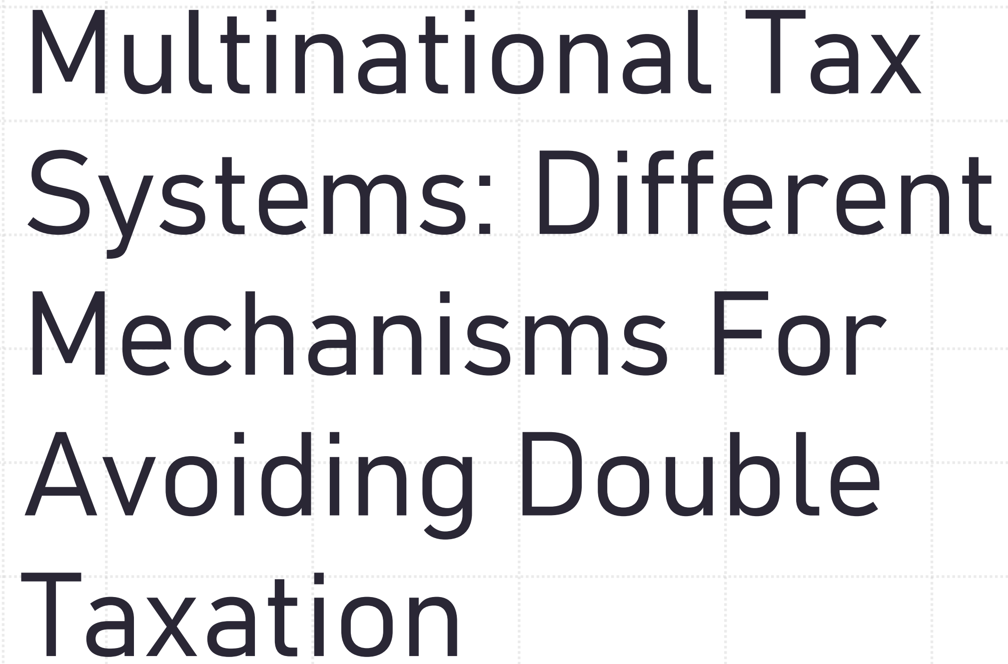
- Rise of intangible assets and digital services call these norms into question

Intangible Assets Give Rise to Profit Shifting

- Intangible assets: intellectual property like drug formulas, technology, algorithms
  - Highly mobile

- Intangible assets complicate the measurement of profit
  - Difficult to value
  - Difficult to enforce rules about how to price transfers between related parties

- What's the game? Transferring income from high to low-tax countries
  - Parent sells intangible asset at (too) high price to foreign subsidiary
  - Foreign subsidiary charges parent high royalty/licensing fee to use asset



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Two General Approaches to Avoid Double Taxation

1. Territorial Tax System
   - Home country forgoes tax on overseas income earned by its resident corporations
   - "Competitive Neutrality": overseas investment faces the same tax rate as foreign competitors

2. Worldwide Tax System
   - Home country taxes all income earned by its resident corporations with credit for foreign taxes paid
   - "Capital Export Neutrality": taxes should be irrelevant to location decision

- Reality: all systems are a hybrid of the two

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Pre-TCJA: U.S. Operated a Worldwide Tax

- Corporate profit subject to 35% tax regardless of where it was earned
  - Tax assessed when foreign earnings brought back to U.S. parent (repatriation)
- Problem: companies could accumulate earnings in low-tax jurisdictions without owing tax
- Clausing (2020) estimates that in 2017
  - $4.2 trillion in earnings accumulated overseas (70% in tax havens)
  - $100 billion lost revenue due to profit shifting

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Tax Credits Blend Income Across Countries

- Foreign Tax Credit: credit for foreign taxes paid
  - Cross-Crediting: excess credits from high-tax countries could offset U.S. tax due on income from low-tax countries
  - Reduces the ultimate tax liability compared to country-by-country taxation
- 2017: $60 billion in FTC for $340 billion in income tax before credits

	Low-Tax Subsidiary	High-Tax Subsidiary
Earnings	$100M	$100M
Foreign Taxes Paid	$10M	$45M
U.S. Taxes Owed	$35M	$35M
U.S. Taxes after Credit	$25M	$-10M
U.S. Taxes Paid	$15M	

TCJA Replaced Worldwide With a Modified Territorial System

- U.S. generally exempts foreign earnings from taxation
  - TCJA retained subpart F rules (tax on certain highly mobile income, regardless of where/when)

- TCJA introduced 3 new international tax provisions

1. GILTI: minimum tax on certain income of foreign subsidiaries
2. FDII: preferential tax rate for income earned from selling goods, services or IP to foreign customers
3. BEAT: anti-tax-avoidance minimum tax on certain deductible payments to foreign affiliates

GILTI: An Example

- Consider a CFC of a US MNC that earned $100 million
  - $60M basis of tangible assets in foreign jurisdiction
- Allowed to earn $6M per year tax free
- 50% of earnings above that are subject to U.S. Corporate tax
  - *Regardless of whether income is repatriated or not*
- *Blended* FTC credits available
  - 80% maximum offset (violates no double taxation principle)

A	**Foreign Income**	**$100M**
B	**Tangible Asset Basis**	**$60M**
C	QBAI Deduction 10% x B	$6M
D	GILTI A – C	$94M
E	GILTI tax base 50% x D	$47M
F	U.S. Tax on GILTI Income 21% x E	$9.87M

Tax competition: Race to the bottom

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Globalization Connects Corporate Tax Policy Across Countries

- Each country chooses its own corporate tax policies
  - Must consider corporate tax policies of other countries
- Multinationals choose where to produce and sell their products
- Countries with relatively low corporate tax rates are more attractive
- Results in tax competition across countries and a global race to the bottom

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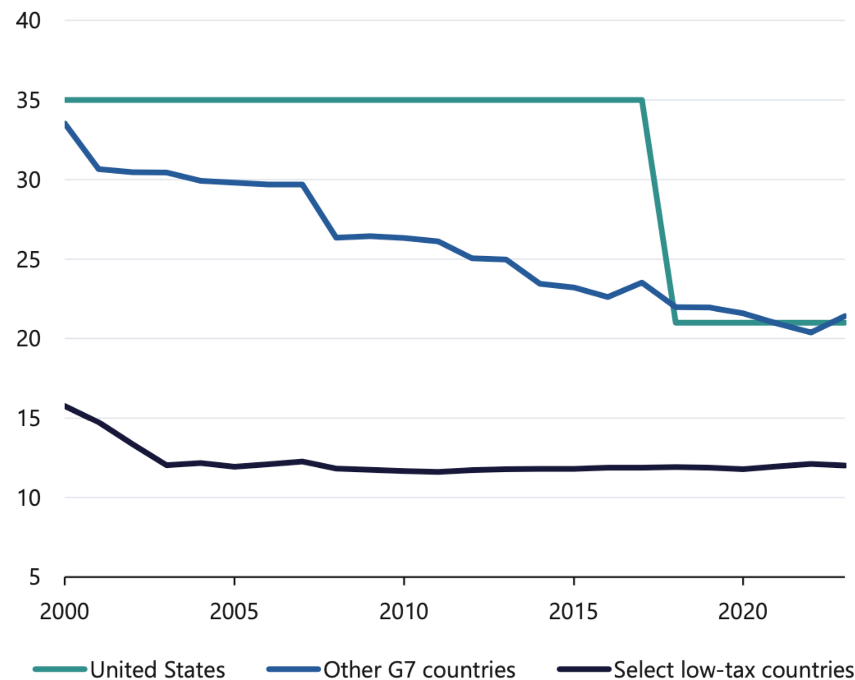
Tax Competition Has Led to a Race to the Bottom in Corporate Tax Rates



- Low-Tax Country ATR: 12%
- G7 ATR has steadily fallen
  - Early 2000s: 30%
  - 2023: 20%
- Tax competition limits everyone's ability to raise tax revenue from business income

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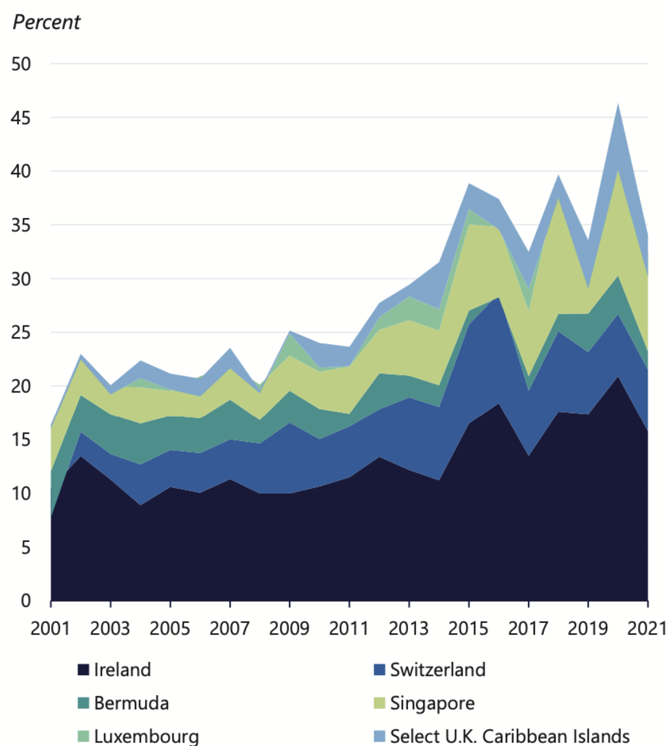
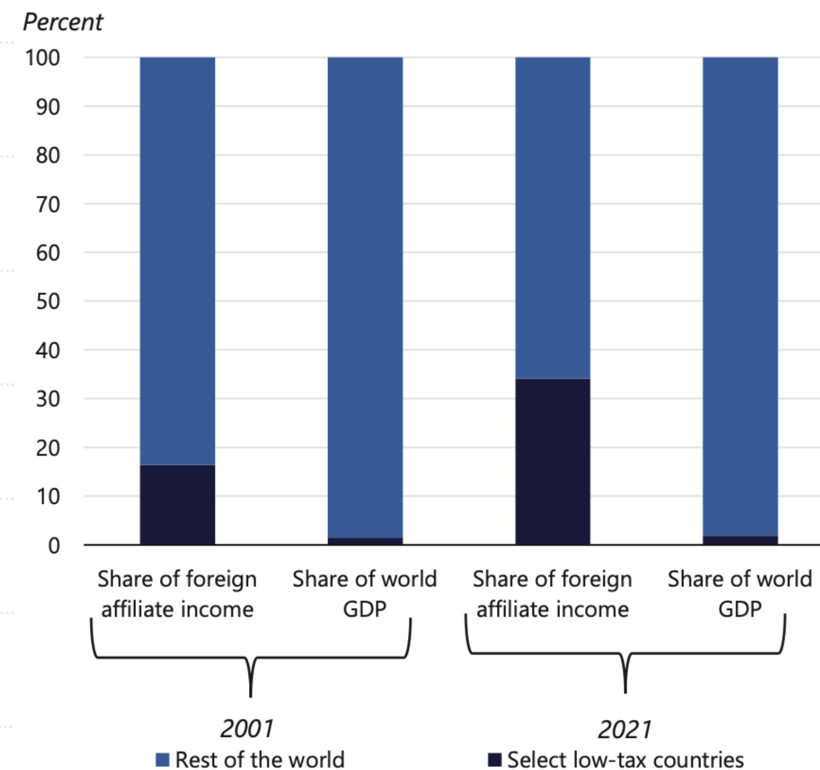
U.S. MNCs Have Responded by Increasing Cross-Border Tax Planning





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Unilateral Action Has Failed to Curb Cross-Border Tax Planning

- Some countries have acted on their own to preserve corporate tax revenue
  - Anti-inversion rules discourage MNCs from relocating headquarters to lower-tax countries
  - Tax policies discouraging profit shifting through Controlled Foreign Corporations (CFCs)

- TCJA centered on business tax reform aimed at on-shoring corporate profit
  - Reduction in corporate tax rate (35% to 21%)
  - GILTI, FDII, BEAT

Indeed, as of the third quarter of 2019, there is no evidence of a reduction in profit shifting or a change in the location of US MNC profits.

Clausing (2020)

International cooperation: Global tax deal

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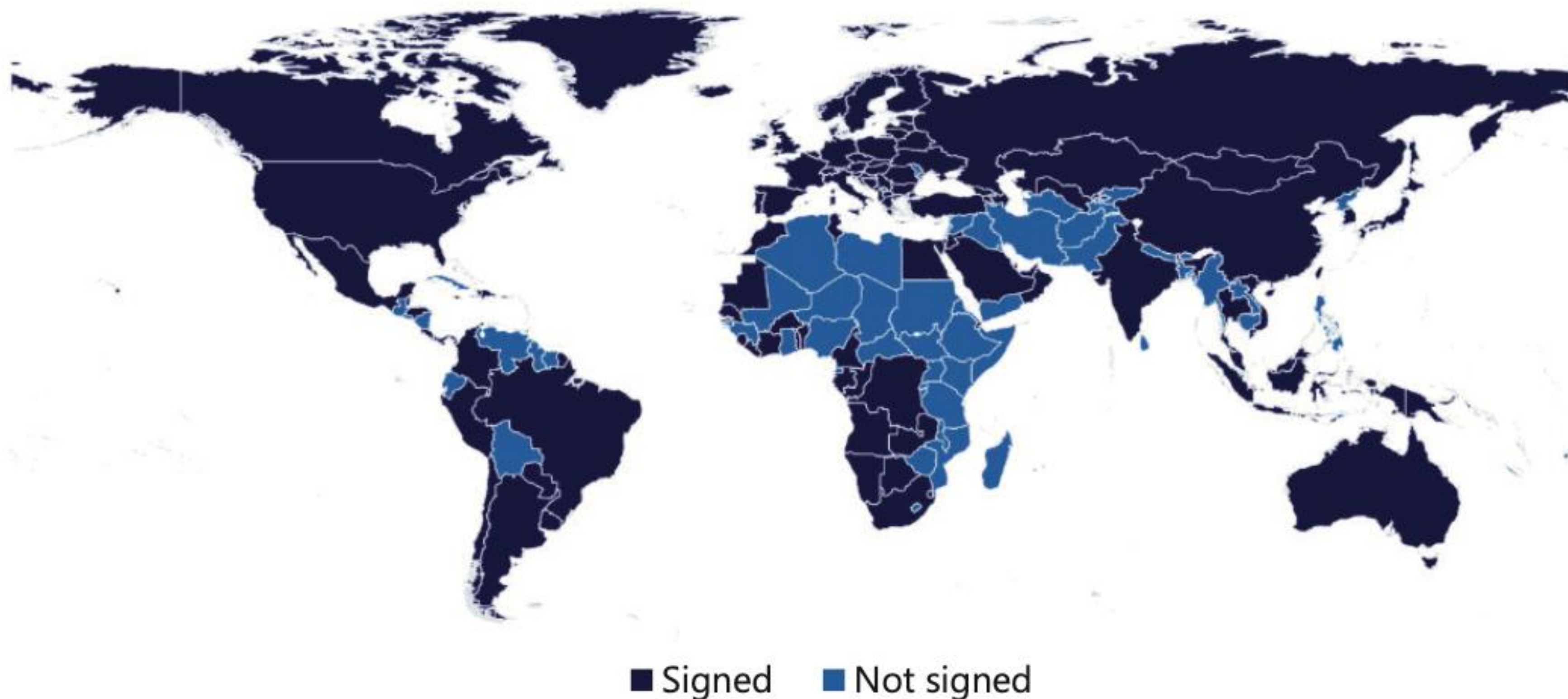
Global Tax Deal Reflects More than A Decade of Ongoing Multilateral Negotiations

- **2013**: OECD launches the Base Erosion and Profit Shifting (BEPS) Project
  - Targeted MNC tax avoidance through profit-shifting and loopholes
- **Late 2010s**: Several countries (e.g. France, UK) introduce Digital Services Taxes (DSTs) targeting large tech companies
  - Increase pressure to find a multilateral solution
- **2021**: More than 130 countries agree to a 2 Pillar framework
  - Pillar 1: addresses where MNCs pay tax
  - Pillar 2: addresses how much MNCs pay in tax
- **2023 – 2024**: Countries begin implementing Pillar 2 (Pillar 1 faces delays)
- **2025**: Uncertainty remains surrounding U.S. adoption

Figure i-3. Countries That Agreed to the October 2021 Global Tax Deal Framework



Council of Economic Advisers

Sources: Organisation for Economic Co-operation and Development; CEA calculations.

Note: Figure shows which countries signed the October 2021 *Statement on a Two-Pillar Solution to Address the Tax Challenges Arising from the Digitalisation of the Economy* as of June 9, 2023.

2025 Economic Report of the President

Pillar 2: 15% Global Minimum Tax

- Goal: reduce tax competition by setting a minimum tax paid by all MNCs, regardless of where they operate
- Which MNCs? Large MNCs!
  - > €750 million (~$800M)
- Pillar 2 relies on 3 self-reinforcing mechanisms to enforce global minimum tax
  1. Income Inclusion Rule (IIR): home country collects top-up tax on low-taxed income of foreign subsidiaries
  2. Undertaxed Payments Rule (UPR): backstop rule taxing low-taxed income when IIR isn't applied
  3. Qualified Domestic Minimum Top-up Tax: local top-up tax that allows low-tax country to collect

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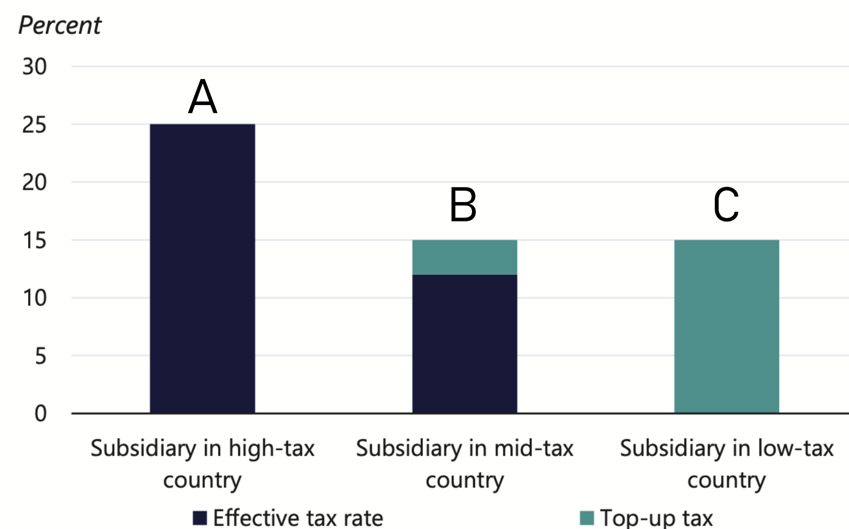
Pillar 2: An Example



- Suppose the US implements an **IIR**
- Consider a US MNC with 3 subsidiaries (A, B, C)
  - US MNC must calculate its **effective tax rate** in each country
- Under IIR the U.S. imposes a **top-up tax** to bring the taxes paid in each country to 15%
  - *Note*: no blending across countries, as in the current U.S. FTC regime

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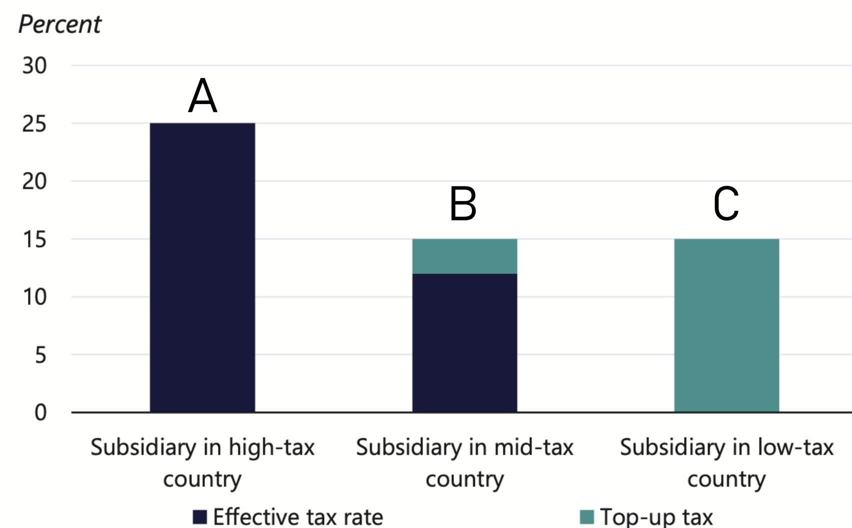
Pillar 2: An Example



- What if the U.S. does not impose an IIR?
- Countries with a UPR can deny deductions to subsidiaries to collect the top-up tax
- Here, the mid-tax country could deny deductions to subsidiary B to collect the top-up tax owed by subsidiary C

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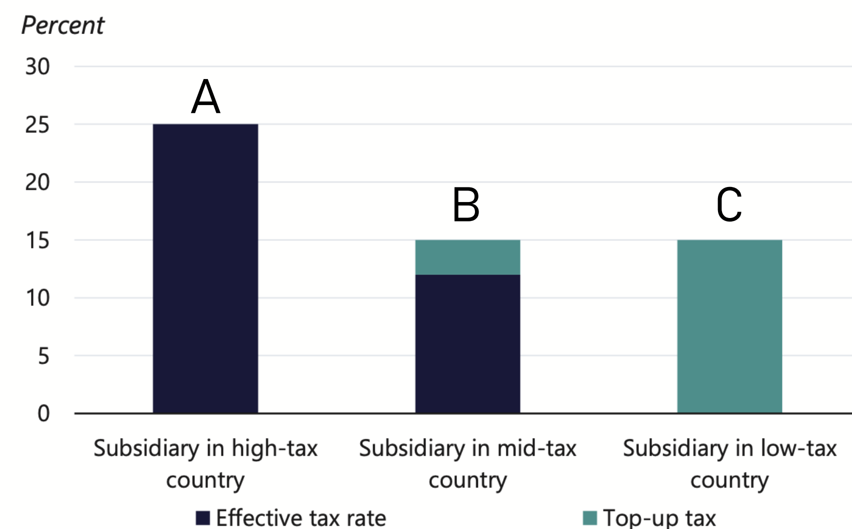
Pillar 2: An Example



- Instead of letting the U.S. or other countries impose a top-up tax, why not raise the effective tax rate for countries operating within your borders?
- Enter QDMTT
- If the mid- and low-tax country imposes their own top-up tax, then they keep the tax revenue
  - Better than allowing other jurisdictions to take this revenue

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Pillar 2 is Self-Reinforcing

- As long as at least one country implements at least one of the Pillar 2 provisions, then tax revenue up to a 15% minimum tax is up for grabs!

- Countries then face a choice
  - Adopt an IIR, UPT, and QDMTT to ensure that they maximize their tax revenue
  - Risk losing this tax revenue to other countries who have implemented Pillar 2

- Pillar 2 eliminates the incentive for any one country to lower its tax rate in such a way that effective tax rates fall below 15%

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Pillar 2 is In-Place or In-Progress in Nearly 70 Countries

- As of September, 2024, 31 countries have enacted legislation to incorporate Pillar 2
  - Most EU countries, Switzerland, Norway, UK
  - Canada
  - Japan, Malaysia, New Zealand, South Korea, and Vietnam

- Another 34 countries have proposed legislation or announced plans to do so

- Notably absent: United States

Rise of Digital Services Motivated the Development of Pillar 1

- Rise of digital services raises fundamental questions about which countries have the right to tax income
  - Recall, norm has been based on the location of production/physical assets
  - Digital services are de-coupled from physical production

- Example: U.S. MNC who operates a search engine
  - Available to customers across the world
  - Business in Canada may buy advertising space and advertisements are viewed by Canadians
  - Who has the right to tax these advertising profits?

- In response to rise of digital services, countries began to unilaterally levy taxes on digital services (DSTs)

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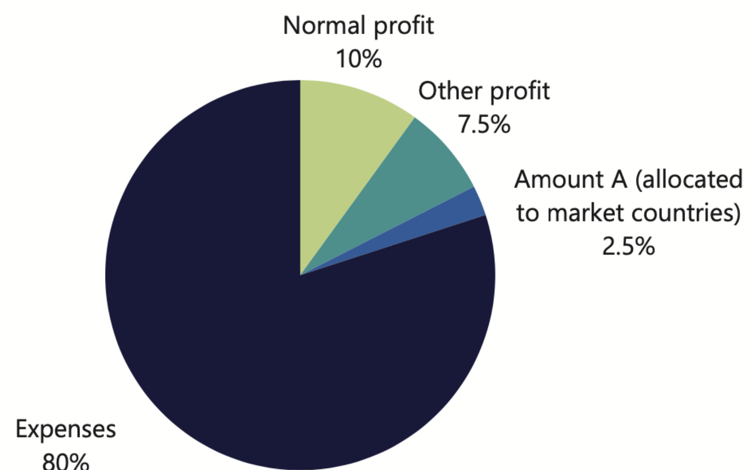
Pillar 1: Addressing Where MNCs Pay Tax In Light of Digitization



- Pillar 1 replaces existing and future DSTs with a unified framework
- Reallocates a portion of MNC profit (Amount A) to "market countries"
  - Countries where customers are located, regardless of physical presence of MNC
- Amount A: 25% of profit exceeding 10% of revenue

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Pillar 1 Most Directly Affects U.S. MNCs

- Amount A applies to MNCs with
  - Global revenues greater than €20 million

  and
  - Profitability greater than 10%

- Devereux and Simmler (2021)
  - 78 of the worlds largest 500 companies would likely be affected
  - 64% of Amount A income associated with U.S. MNCs

- Pillar 1 is still under negotiation!

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Should the U.S. Adopt the Global Tax Deal? Pros

- Uncoordinated tax competition has harmed the U.S.
  - Lost tax revenue
  - Inefficient profit-shifting
  - Lost domestic investment

- Pillar 2 is self-reinforcing, and the train has left the station
  - As 70+ countries begin to enforce Pillar 2, the U.S. is simply forgoing tax revenue

- Pillar 1: U.S. MNCs are already subject to a patchwork of DSTs

- U.S. negotiators have been a key participant in on-going negotiations since the early 2010s

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Should the U.S. Adopt the Global Tax Deal? Cons

- Some see Pillar 1 as capitulation because it disproportionately affects U.S. MNCs
- Pilar 2: Effective Tax Rate calculation requires a common definition of income
  - Not as easy as it sounds
  - We implement a lot of business policy through the tax code by creating special deductions and credits
  - These deductions and credits may not comport to a global definition of taxable income

Lingering Issue: How to Achieve a 15% Minimum Tax in the U.S.?

- Pillar 2 requires a 15% global minimum tax

- U.S. effective corporate tax rate is roughly 11%
  - Too low!

- How can we raise the effective tax rate?
  - Corporate AMT?
    - Affects very few firms, and necessarily refundability raises issues in the context of GTD
  - GILTI?
    - A kind of minimum tax!
    - But GILTI applies a global minimum rate *across countries*
    - Pillar 2 requires country-by-country minimum tax

Questions?

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