

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



Boycott tax evasion. #BoycottStarbucks.



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

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

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?

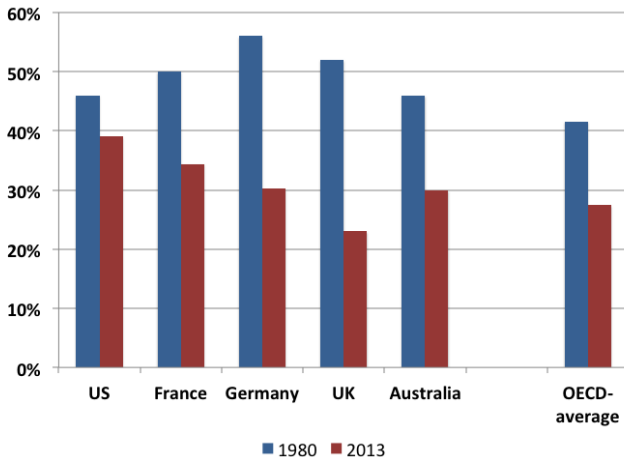
- Shareholders might not bear the full economic incidence of corporate incomes taxes
- One reason - capital is more mobile than workers
 - a firms can move it's investment to another country, most people won't move to another country to work
 - if corporate income taxes are high in one country then a 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



And offered preferential rates to income from intellectual property

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

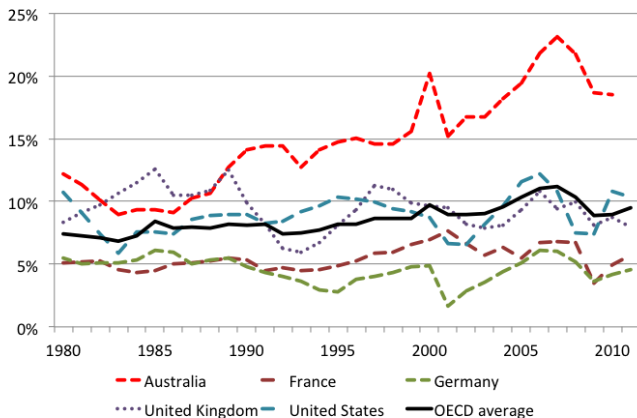


Country	Preferential rate	Main rate
Netherlands	5	25
Luxembourg	5.8	29
Belgium	6.8	34
UK	10	23

- Statutory tax rates have fallen substantially
- Has revenue from corporate income tax declined?

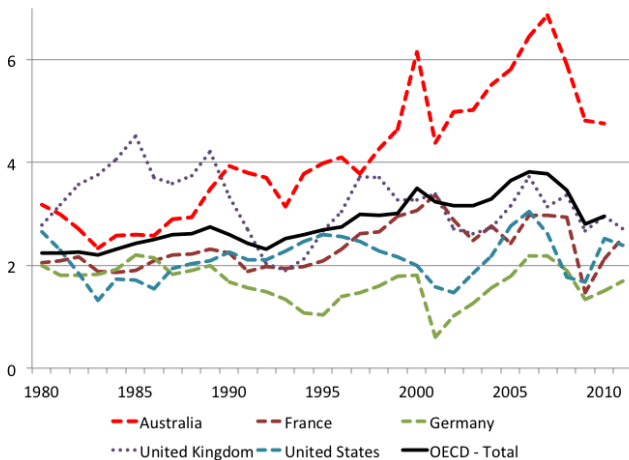
Corporate income taxes as a share of total tax revenue

% total tax revenue



Source: OECD

Corporate income taxes as a share of GDP



% GDP
Source: OECD

Why have revenues stayed bouyant when corporate income tax rates have fallen?

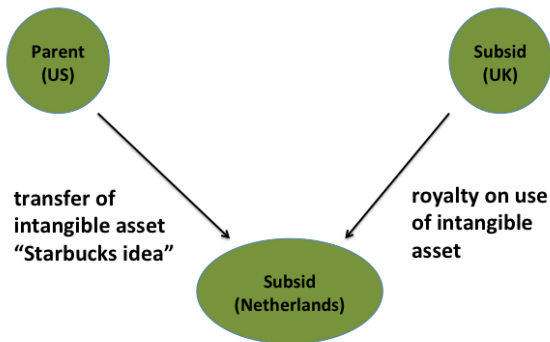
- Despite the long running concerns and the claims that companies do not pay enough tax, revenues from corporate income taxes have been surprisingly buoyant
- This is mainly because corporate profits have increased as a share of GDP
 - share of activity that is in corporations has increased
 - profitability 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 it's 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 resided
- 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