ICRICT

Independent Commission for the Reform of International Corporate Taxation

ICRICT NEW REPORT: "A ROADMAP TO IMPROVE RULES FOR TAXING MULTINATIONALS"
EXECUTIVE SUMMARY

CURRENT PROBLEM:

- The current dysfunctional international taxation system based on the arm's length principle and transfer pricing rules has allowed multinational enterprises to shift large portions of their overall profits from both developed and developing countries to low tax jurisdictions (tax havens) and avoid bearing their fair share of taxation. These practices rob governments and citizens of funding for vital services and are contributing to unprecedented levels of economic inequality across the world.
- OECD'S BEPS (Base erosion and Profit Shifting) project is failing on its mandate to ensure that profits are taxed where economic activities take place and value is created. As a result, countries are moving unilaterally to introduce alternative or adjunct tax rules (UK Diverted Profit Tax, US tax reform, web tax in India – also proposed by a number of EU countries.)
- The US tax reform move to territorial taxation coupled with a significant drop in the corporation tax rate (from 35 to 21%) is likely to fuel a global race to the bottom in cuts to corporate tax rates, with developing countries standing to lose the most as a result.
- Developing countries rely on corporate tax revenue for a significantly higher share of all tax revenues, with corporate tax revenue representing on average around 10% of their total government revenues, compared to 5% on average in developed countries.

ICRICT SOLUTION: GLOBAL FORMULARY APPORTIONMENT AND MINIMUM CORPORATE TAX RATE

- ICRICT **proposes an alternative solution to a failing system. Global formulary apportionment, coupled with a minimum corporate tax rate, is the only effective way for all countries to collect a fair share of tax revenue from multinational enterprises and avert a race to the bottom.**

- Multinationals are groups of entities that are under single management control and have a single set of owners, and should therefore be taxed as unitary firms. A unitary approach should apportion the multinational's global profits to the different countries through a simple allocation formula, based on objectively verifiable factors. These factors, such as employment, sales, resources used, fixed assets, etc., should be chosen in a balanced way reflecting both supply (e.g., assets, employees, resources used) and demand (sales). Neither can create value without the other.

  Under global formulary apportionment, and assuming a formula with equally weighted factors (sales 33%, assets 33% and employees 33%), the consolidated global profits of multinational X with operations in country A (10% of global sales, assets and employees), B (20% of global sales, assets and employees), C (70% of global sales, assets and employees), will be allocated and taxable in country A (10% of global profits), B (20% of global profits) and C (70% of global profits) respectively.

- **The Commission urges global leaders to adopt a roadmap towards this goal of global formulary apportionment with a minimum corporate tax rate, including short-term measures that are more effective, easier to administer, and provide greater certainty than the current defective methods.**

CORPORATE TAX AVOIDANCE BY MULTINATIONALS: KEY FACTS

- IMF's Fiscal Affairs Department (Crivelli et al., 2016[1]) estimates annual total corporate tax losses associated with profit shifting at more than **$500bn**, with **$400bn** for OECD member states and around **$200bn** for lower-income countries per annum.
- Tax Justice Network researchers (Cobham, A, & Janský, P., 2018[2]) estimate annual corporate tax losses of **$500bn** per annum due to profit shifting.
- Profit shifting by MNEs is estimated to cost EU member states **€50-70bn** per annum[3].
- Profit shifting by U.S. multinationals alone is estimated to cost the U.S. government and citizens between **$77-$111bn** per annum (Clausing, K, 2016[4]).

[1] Crivelli, E., de Mooij, R., & Keen, M. (2016). Base Erosion, Profit Shifting and Developing Countries. FinanzArchiv: Public Finance Analysis, 72(3), 268–301.
[2] Cobham, A, & Janský, P. (2018). Global distribution of revenue loss from corporate tax avoidance - Re-estimation and country results. Journal of International Development, Forthcoming. Ungated version:
[3] http://www.europarl.europa.eu/legislative-train/theme-deeper-and-fairer-internal-market-with-a-strengthened-industrial-base-taxation/file-quantification-of-the-scale-of-tax-evasion-and-avoidance
[4] http://www.taxanalysts.org/content/effect-profit-shifting-corporate-tax-base

- Latest research indicates that a move **to global formulary apportionment** will benefit both developed and developing countries (Cobham, A, & Janský, P., 2017[5] and Zucman et al., 2017[6]) to the detriment of tax havens.
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GLOSSARY

- **Arm's length principle:** the principle underpinning the current international tax rules. This requires multinationals to calculate their taxable profits in each jurisdiction by assuming that any transaction (interest, licensing of intellectual property (IP), sale/purchase of product/services) between two related parties (two entities within the same multinational) must be the same as if the parties were *not* related. An arm's-length price (i.e. **the transfer price**) for a transaction is therefore what the price of that transaction would be on the open market.
- **Profit shifting:** the allocation of income and expenses between related corporations or branches of the same legal entity (e.g. by using transfer pricing) in order to reduce the overall tax liability of the group or corporation.
- **Global formulary apportionment:** a mechanism to allocate the multinational global profits (as reported in the consolidated accounts) to different countries through the use of a formula based on allocation factors. For example, under global formulary apportionment, and assuming a formula with equally weighted factors (Sales 33%, Assets 33% and Employees 33%), the consolidated global profits of multinational X with operations in country A (10% of global sales, assets and employees), B (20% of global sales, assets and employees), C (70% of global sales, assets and employees), will be allocated and taxable in country A (10% of global profits), B (20% of global profits) and C (70% of global profits) respectively.
- **Territorial taxation**: under a territorial taxation system, US multinational corporations are taxed only on the profits generated locally (i.e. within the US) and overseas profits of US multinational corporations are not taxable in the US.

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[5] Cobham, A, & Janský, P. (2017) Measuring Misalignment: The Location of US Multinationals' Economic Activity versus the Location of their Profits.
[6] http://gabriel-zucman.eu/files/TWZ2017.pdf