RECENT DEVELOPMENTS IN INTERNATIONAL CORPORATE TAXATION

9th IMF-Japan High Level Tax Conference

Tokyo: April 10, 2018

Views expressed here are mine, and should not be attributed to the IMF, its Executive Board or its management

Many and fast-moving developments

- Implementation of G20-OECD Base Erosion and Profit Shifting (BEPS) outcomes
- Re-launch of European Commission's 'CCCTB'
- Digitalization: OECD report and EU proposal
- Many unilateral reforms
- U.S. tax reform—will impact all of these debates

Digitalization and international tax

Implications of digitalization—contentious!

Core issues: Should uptake of user-generated value create nexus? If so, how allocate profit?

Key developments:

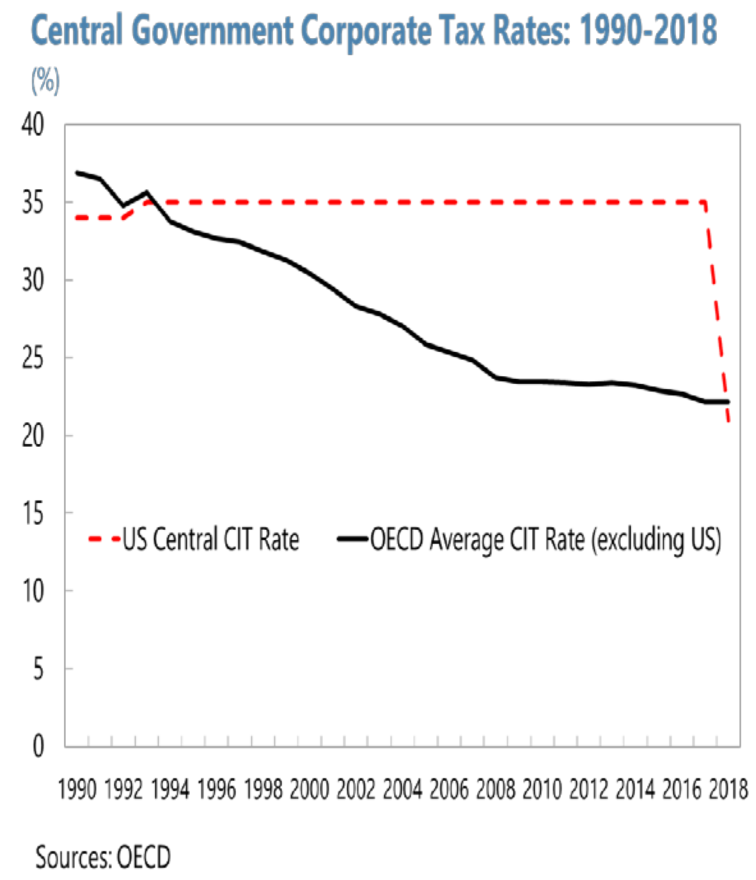
- OECD interim report: Does not support measures but
  - Urges that any adopted be consistent with international obligations, "temporary, timely and balanced," minimize compliance, not inhibit innovation…
- European Commission proposal:
  - Short-term: 3 percent excise on revenues from certain digital activities
  - Long-term: "Significant digital presence" test for 'virtual' PE

Core elements of the U.S. reform

Reduction in headline CIT rate

- Many elements affect business
  - Pass throughs, PIT
- CIT rate cut the centerpiece
  - Restores U.S. to OECD mean
  - Literature suggests others will respond:
    - 'impact effect' a 2-3 pp cut
    - larger when interactions play out

But this neglects distinctive aspects of the reform



Finance and investment

<u>Limitations on interest deductibility</u>

Eases debt bias and debt shifting

<u>Immediate expensing of investment</u>

'Cash flow' treatment

<u>Combined effect</u>

- Equity investment becomes more attractive
- Debt financed investment may become less attractive

Focus on the international provisions

‘Territoriality’—modified ’

No U.S. tax on active business income earned abroad

- The norm in advanced countries
- Evidence from U.K. that spurs outward investment
- May encourage downward competition

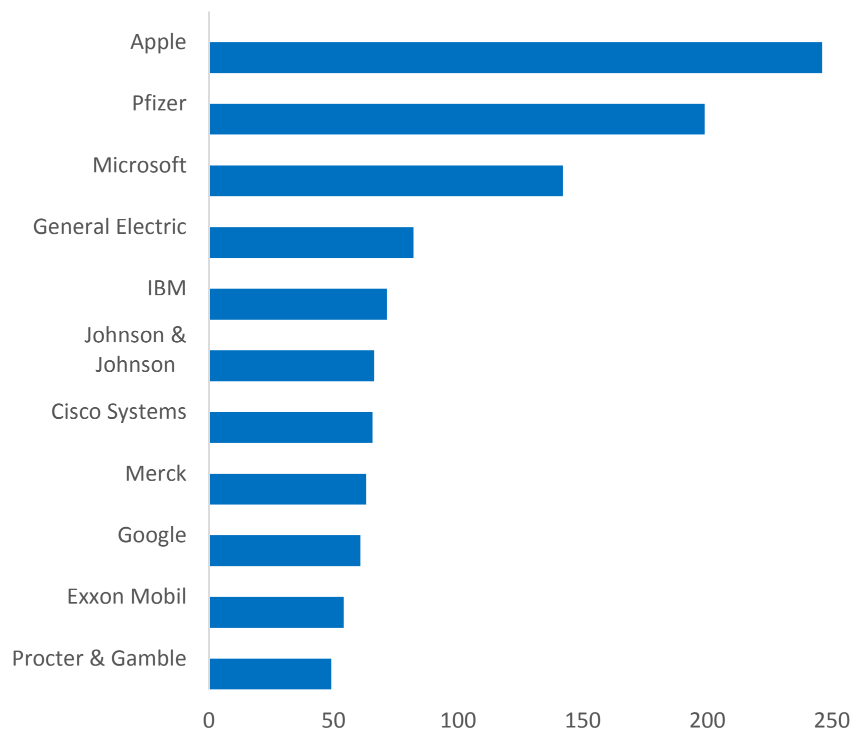
But…

Deemed repatriation

U.S. tax was deferred by not repatriating

- Accumulated stock ($2.5 trillion) now to be taxed (over 10 years) at
  - 15.5% if held in cash/equivalents
  - 8% otherwise

- Underlying assets believed already largely in U.S., so inflows unlikely to be major



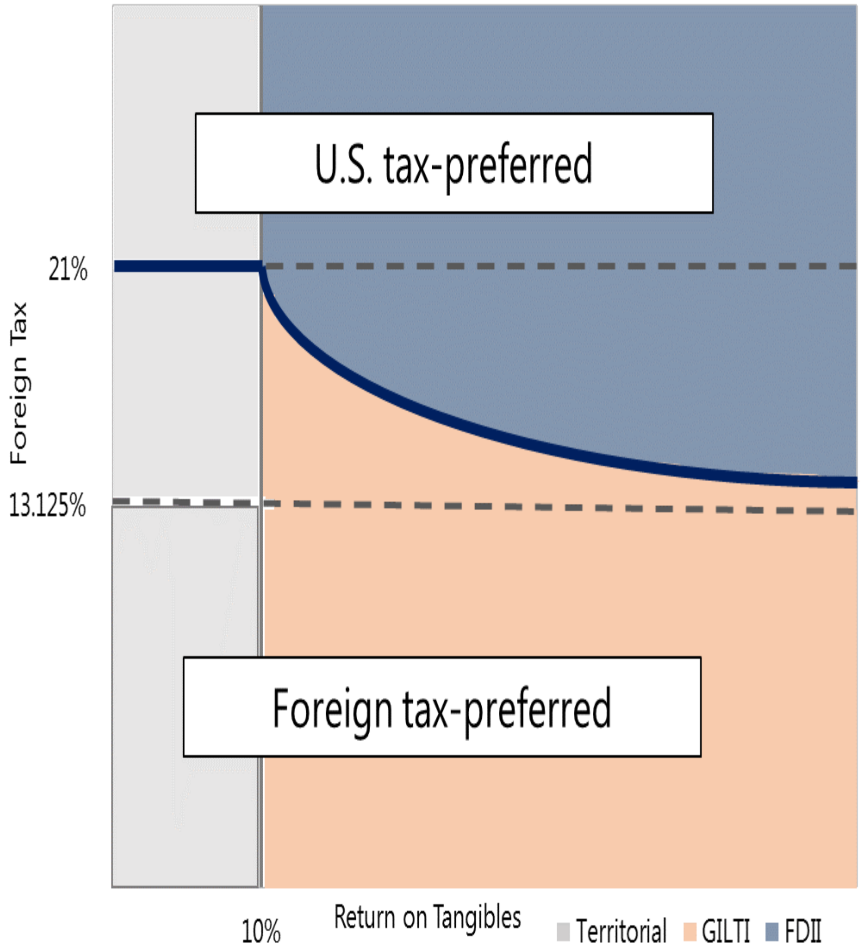
Source: Institute on Taxation and Economic Policy

Three (very) consequential innovations

GILTI	FDII	BEAT
U.S. tax on income above 10% return on tangible assets at least 10.5% but no more than 13.125%	Tax of 13.125% on earnings from foreign sales by U.S. corporations above a 10% return on tangible assets	Minimum tax when avoidance-prone payments (interest, fees …) large
Reduced gain from locating this income in lower taxed jurisdictions	Tax concession where local assets/production serve foreign markets WTO consistency questions raised	More aggressive than BEPS Tax treaty questions raised

Complex! E.g. for outward investment

US corporations? Produce for foreign sales at home/abroad? Depends on foreign tax and return on tangibles



Foreign countries?

- Points to a band:
  - Higher than 21 unattractive
  - Lower than 13.125 unnecessary
- Incentive to attract tangibles
  - Depreciation allowances etc.
  - Temporary break for reinvested profits

Concluding

- Now is a time of heightened uncertainty in international taxation, both
  - Immediate: BEPS, Digitalization, US tax reform
  - Long-term: Unprecedented progress has been made in international tax cooperation, which it is important to maintain

Extra

Implications: Inward and external

Inward investment

- Lower average and (less certainly) marginal effective rates encourage investment in the U.S…
- …but BEAT may mitigate this…

External

- Increased rates in low tax jurisdictions would reduce profit shifting out of high rate ones
- Many instruments for possible response beyond rate, such as:
  - Investment incentives?
  - Measures similar to BEAT etc.?