International tax reform:  
how fundamental is “fundamental”?

Michael Devereux
“It is ... important to revisit some of the fundamentals of the existing standards. Indeed, incremental approaches may help curb the current trends but will not respond to several of the challenges governments face.”

OECD, BEPS report, 2013
Some fundamental questions

1. What challenges do governments face?
2. Why tax corporate profit at all?
3. How should profits be allocated?
4. Where will a fundamentally un-reformed system lead us in twenty years?
5. Is it possible to move away from the arms’ length standard?
6. What other options are there?
What challenges do governments face?

- Raising revenue (in a time of austerity)
  - Demanding for tax authorities
- Stimulating investment and growth

*Is any competition beneficial from a public policy perspective?*
Why tax corporate profit at all?

- Ability to pay: a proxy for personal income tax?
- Payment for a benefit?

*Neither suggests anything like conventional corporation taxes*
How *should* profits be allocated?

“aiming at better aligning rights to tax with real economic activity” OECD

- Where does a multinational company make its profit?
  - many *necessary* places, but no *sufficient* place

- Multinationals make more profit *because* they are multinational
  - “group synergies” in OECD terms
How *should* profits be allocated?

- Should allocation of profit depend on how activity is financed?

- Some income taxed where “corporate” owner resides – is this where the “real economic activity” is?

_Ultimately, no conceptual basis for allocation of profit_
Where will a fundamentally un-reformed system lead us in twenty years?

Can incremental reforms save the system?

Revenues driven down by:

- Competition driving down rates
- Cross-country arbitrage opportunities
  - maintenance of corporation tax revenues is misleading
Is it possible to move away from the arms’ length standard?

- How much international co-ordination does the alternative require?
What other options are there?

- Formula apportionment
- Destination-based tax
- A simpler tax base
Formula apportionment

- Requires international agreement
  - Water’s edge problems
  - Would there be an incentive for countries to join an apportionment region?
- May not reflect true location of profit?
- Would still affect location decisions
Destination-based tax

- Similar to VAT: zero-rate exports and tax imports
  - Ideally combine with cash flow treatment (100% allowances, no deduction for costs of finance)

- BUT: a tax on profit, *not* value added, since labour costs deductible
Destination-based tax

- In principle, if
  - residence of consumers can be identified, and
  - consumers immobile

then tax would not affect business decisions on location, investment or finance

and within-group transactions would not be subject to tax
Destination-based tax

- Reflects an “opportunity to tax” – based on location of consumers

- Many practical issues to be resolved

- Including whether a single country could (and should) implement a tax on its own

- Work is ongoing, drawing on experience of VAT
A simpler tax base

Some criteria for choosing base:

- Relatively easily observable
- Not obviously unfair
- No worse in distorting behaviour, and
- Can it be implemented unilaterally?
Final thoughts

Much disagreement arises because reform proposals having different starting places

- What is fundamental?
  - Clean sheet v adjustment to existing system

What standards should be used for judging alternatives?

- Not necessarily seeking a perfect solution: is it likely to be better than the one we have?