

Reforming Corporate Taxation in a Global Economy: A Proposal to Adopt Formulary Apportionment

Hamilton Project

**Reuven Avi-Yonah and Kimberly A. Clausing
June 2007**

The Current System of Taxing Corporations

- based on separate accounting
- deferral and cross crediting => incentive to book income in low tax countries
- many sources of complexity

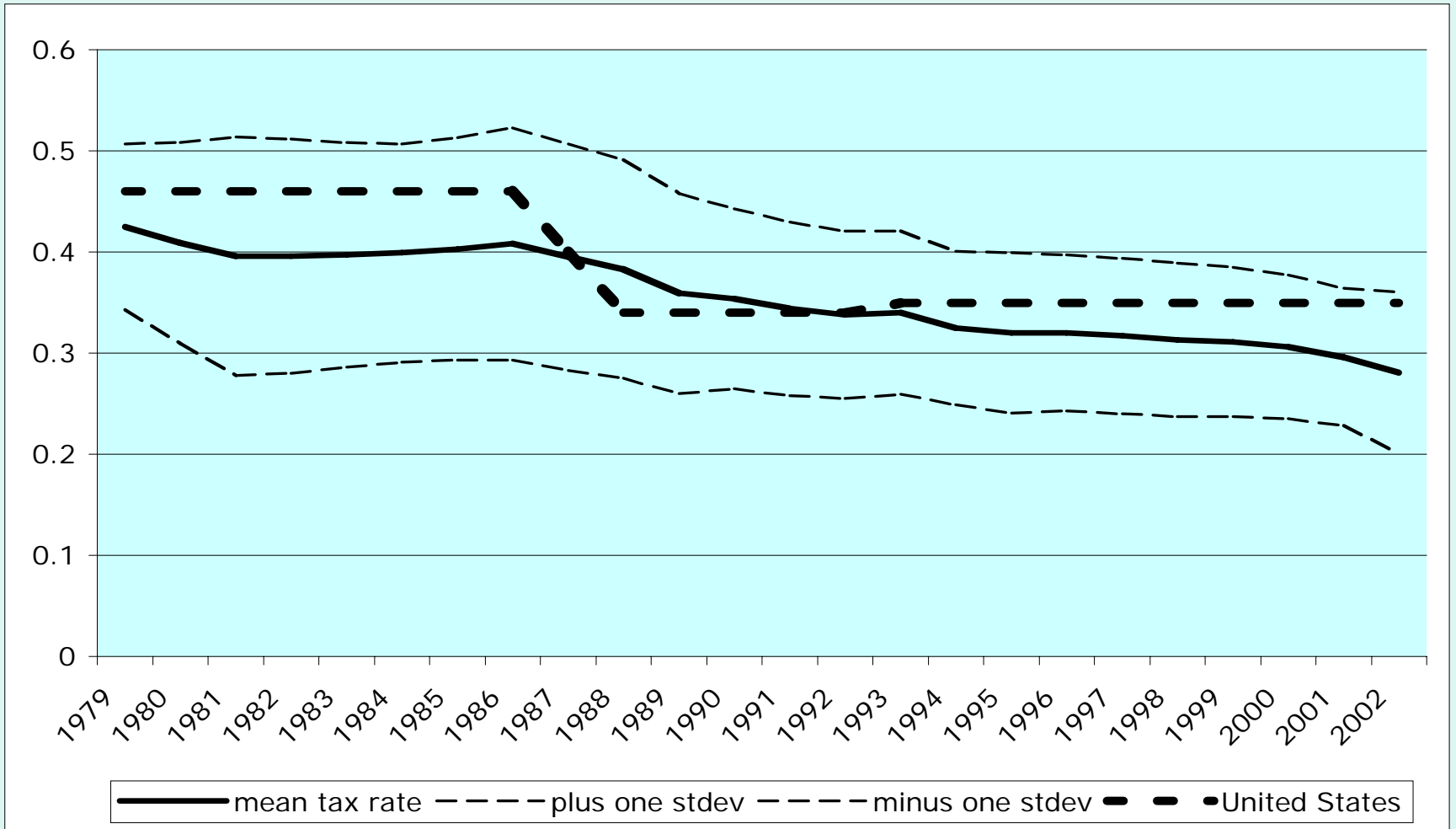
Proposed System of Formula Apportionment

- tax base is worldwide income, independent of residency
- fraction taxable in the U.S. depends on formula
- proposed formula based on sales only

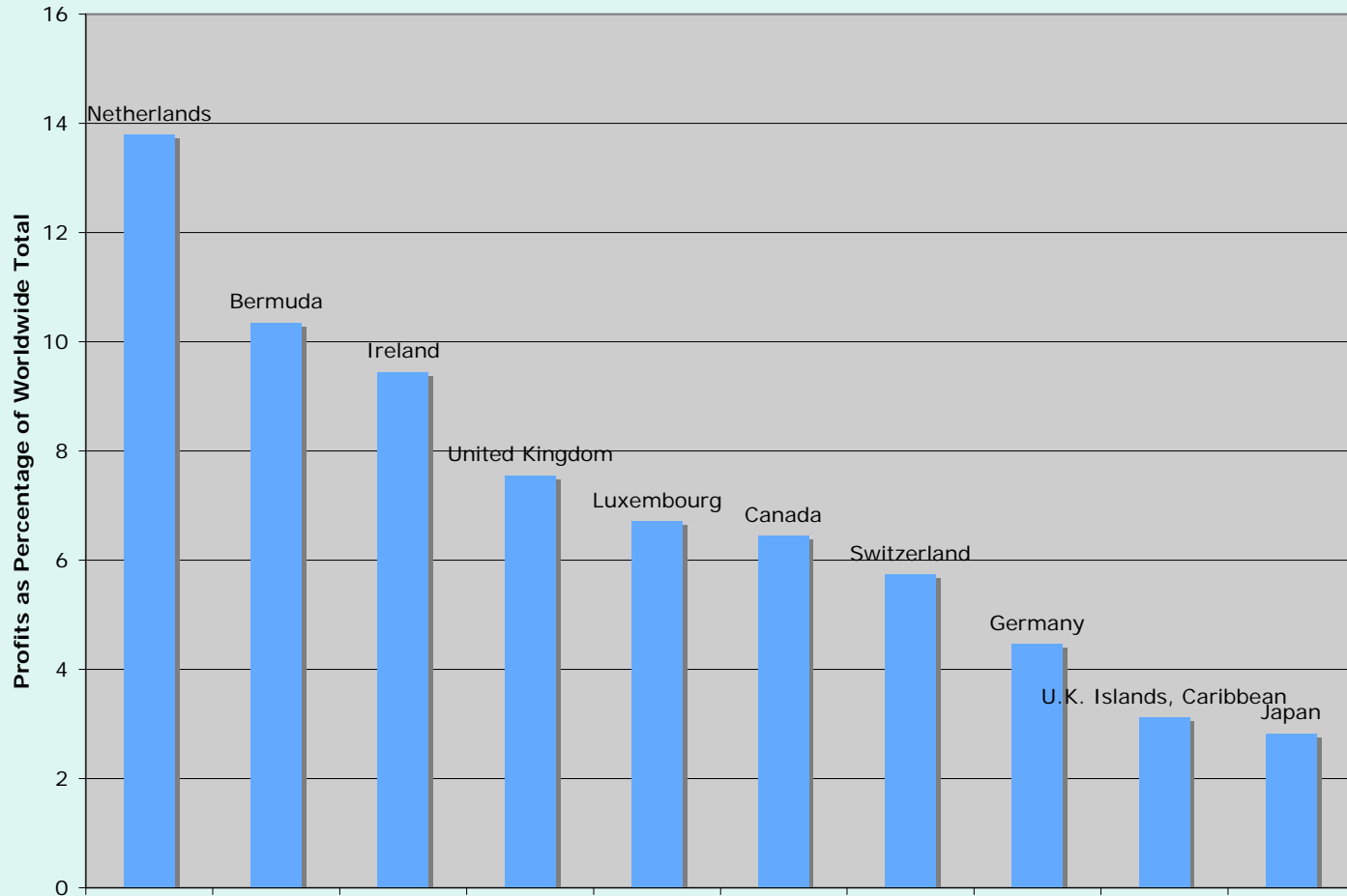
Flaws in the Current System and Formulary Apportionment as a Solution

1. Not suited to truly global economy
2. Incentive to shift income and economic activity to low-tax countries
3. Complex: sourcing of income and expenses, transfer pricing issues
4. U.S. government revenue low & tax rate high

OECD Corporate Tax Rates, 1979-2002



Distribution of U.S. MNE Profits in 2003



Implementation Issues

- Potential for Zero/Double Taxation
- Defining Unitary Business
- Determining Location of Sales
- Accounting Issues
- Treaty Issues
- Stakeholders