Comments on Dharmapala & Dyreng/Hanlon

Brookings Institution

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Dharmapala: "*Do Multinational Firms Use Tax Havens to the Detriment of Other Countries?*"

Thought-provoking regarding the role of non-haven laws.

- Non-havens have laws that facilitate profit shifting.
- Non-havens often fail to use tools that would curb profit shifting.

Puzzle: Why do policymakers "*fail to respond to what has become a highly salient public concern*"??

1. Collective Action Problems?
2. Could it help welfare at home?
3. Does it reflect political dysfunction?

Collective Action Problems

Prisoners' Dilemma in Action

OECD/G20 role encouraging positive spillover policies like minimum tax/ CFC rules. Even if countries *could* do solo.

National welfare isn't necessarily the right way to view foreign-to-foreign tax avoidance; foreign countries have multinational companies too.

But, big countries can do a lot by themselves! So why not?

Does it help welfare at home?

Maybe, if K is mobile.

Global K stock less tax sensitive than national K stock =>
again a role for coordination.

Important role of rents and excess profits.

Can we make a smarter corporate tax?

What tax revenue is the counterfactual? Or?

The Role of Political Dysfunction

Why do policymakers “*fail to respond to what has become a highly salient public concern*”?

Political dysfunction is not to be minimized in DC today.

This happens a lot. Other examples (Pew data):

- Climate change:

  67% of Americans think govt. should do more.
- Gun violence:

  >90% support mental health limits; 80% support background checks at gun shows; 60% favor generically stricter laws … yet…

Dyreng and Hanlon:
“*Tax Avoidance and Multinational Firm Behavior*”

Cool evidence on many questions:

- Loss/profit persistence
- Global companies (more of them; more global)
- Tax transparency matters (intriguing policy tool)
- Role of financial accounting incentives (does this have implications for Warren/Biden proposals?)
- Why don’t more companies avoid taxes? Fixed costs are key, and that explains many puzzles in the data.

=> Adjustment to tax rate changes will not be smooth; nonlinearities matter a lot (implications for TCJA)

Also, some possible additions.

- What do tax payments mean w/o trends in profits?
  - profits rising relative to GDP
- What does data on a distribution mean when actors are skewed? Thousands of companies.
  - Useful to weight by company size.
  - Compare similar companies across groups.
    Synthetic matching?
  - See Bilicka’s recent AER paper!
  - Important role of nonlinearity. See Dowd Landefeld Moore. J Pub Ec.
- Do other taxes matter? Who pays them? Distinguish incidence.

How Big Is Profit Shifting?

- Both papers a bit skeptical and note differences across studies.
- Magnitude differences depend on type of data.
- Many differences in sources re. coverage, definitions, tax/book, etc.

But not all data sets created equal.

Popular Data Sources

- Orbis / Compustat
- Company level data, ***but:***
  - Misses almost all haven income
  - Nonlinearities are important => havens key
  - Big companies do most shifting; don't treat all companies the same; the tail is different (Wier and Reynolds)
  - Many companies report positive accounting profits and zero tax profits (see Bilicka, again!) => accounting data underestimates for this reason

Don't look under the lamppost for your keys if you dropped them in the dark.

Other Data Sources

- BEA
  - Direct investment earnings series (preferred)
  - Net income (but double counting)
  - Subtracting equity income appears to lose some profit shifting (among foreign countries)
  - Profit type return also has that problem
  - There are large amounts of untaxed foreign profit; foreign to foreign shifting is important.
- Tax Data (form 5471)
- Country by Country Data (form 8975)
- Macro Data

A Comparison of US Data Sources

Table 1: Foreign Profits, in millions, 2016

	BR Subtraction Method	BEA Balance of Payments Direct Investment Income		IRS Country by Country Data (income series are before tax)		
	Net inc.+ for. tax- equity inc.	after tax (reported)	before tax (calculated)[7]	Full Sample	Positive Profit	Accumulated Earnings
All countries[8]	420,565	427,542	514,483	492,237	698,109	3,549,053
Stateless				120,847	142,019	661,980
Puerto Rico				38,925	39,173	99,765
Ireland	77,369	52,366	56,578	31,390	44,921	236,340
Luxembourg	-963	34,819	36,327	-2,139	23,321	195,507
Netherlands	14,675	72,130	77,423	37,642	45,580	387,959
Switzerland	43,098	30,321	33,970	-6,204	30,562	309,623
Bermuda	-1,602	41,554	42,300	24,900	33,148	478,127
UK Caymans[9]	11,850	26,279	26,727	23,792	28,745	78,663
Singapore	27,573	25,002	27,358	29,040	31,021	96,812
Haven Total (w/ ½ stateless)	172,000	282,471	300,683	237,770	347,481	2,213,786
Haven Share	41%		58%	48%	50%	62%

Other Puzzles in US Data

Earnings Over Ten Years (2007-2016), Compared with Accumulated Earnings in 2016

	BEA Data: Subtraction Method (2007-2016)	BEA Data: Direct Inv Income (2007-2016)	IRS Country by Country Data: Accumulated Earnings (2016)
All Foreign	3,723,434	3,356,885	3,549,054
Seven Havens	1,127,960	1,801,848	2,114,024
of which, Bermuda	94,991	281,087	478,127
Seven Haven Share	30.3%	53.7%	59.6%

Note: Seven havens include Bermuda, Caymans, Ireland, Luxembourg, Netherlands, Singapore, and Switzerland. For accumulated earnings, I also include half of the "stateless" income line, which totals $330 billion in 2016.

Likely Scale of Profit Shifting
US Country by Country Data in 2016

	Full Country by Country Sample	**Positive Profits Only, Country by Country Sample**
Estimate of a 35 percent country by country minimum tax	$109 billion	$169 billion
Assigning all havens (defined as effective tax rate < 10%) the world average profit/employee ratio	$78.8 billion	$120 billion
Removing tax elasticity and reallocating existing profits accordingly	$101 billion	$138 billion
US Corporate Tax Revenue in 2016: $311.9 billion		

Should we care? Yes.

Dyreng and Hanlon: divorcing tax from economic reality seems odd to some managers (even)

C-by-c data: $45m in profit per worker in Bermuda.

Is that reasonable? (1,000x world average)

<u>Bigger Issues</u>

Opportunity cost of lost revenue

Integrity of tax system

Efficiency goals

Equity goals

Difficulty of K taxation for individuals:

70% equity income untaxed in United States

mark-to-market and wealth tax far from trivial