Comments on Dharmapala & Dyreng/Hanlon

Brookings Institution

Kimberly Clausing
19 December 2019
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!
- 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

<table>
<thead>
<tr>
<th>BR Subtraction Method</th>
<th>BEA Balance of Payments Direct Investment Income</th>
<th>IRS Country by Country Data (income series are before tax)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Net inc. + for. tax-equity inc.</td>
<td>after tax (reported)</td>
</tr>
<tr>
<td><strong>All countries</strong></td>
<td>420,565</td>
<td>427,542</td>
</tr>
<tr>
<td><strong>Stateless</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Puerto Rico</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Ireland</td>
<td>77,369</td>
<td>52,366</td>
</tr>
<tr>
<td>Luxembourg</td>
<td>-963</td>
<td>34,819</td>
</tr>
<tr>
<td>Netherlands</td>
<td>14,675</td>
<td>72,130</td>
</tr>
<tr>
<td>Switzerland</td>
<td>43,098</td>
<td>30,321</td>
</tr>
<tr>
<td>Bermuda</td>
<td>-1,602</td>
<td>41,554</td>
</tr>
<tr>
<td>UK Caymans</td>
<td>11,850</td>
<td>26,279</td>
</tr>
<tr>
<td>Singapore</td>
<td>27,573</td>
<td>25,002</td>
</tr>
<tr>
<td><strong>Haven Total</strong></td>
<td>172,000</td>
<td>282,471</td>
</tr>
<tr>
<td>(w/ ½ stateless)</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Haven Share</strong></td>
<td>41%</td>
<td></td>
</tr>
</tbody>
</table>
### Other Puzzles in US Data

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

<table>
<thead>
<tr>
<th></th>
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<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>All Foreign</td>
<td>3,723,434</td>
<td>3,356,885</td>
<td>3,549,054</td>
</tr>
<tr>
<td>Seven Havens</td>
<td>1,127,960</td>
<td>1,801,848</td>
<td>2,114,024</td>
</tr>
<tr>
<td>of which, Bermuda</td>
<td>94,991</td>
<td>281,087</td>
<td>478,127</td>
</tr>
<tr>
<td>Seven Haven Share</td>
<td>30.3%</td>
<td>53.7%</td>
<td>59.6%</td>
</tr>
</tbody>
</table>

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

<table>
<thead>
<tr>
<th>Description</th>
<th>Full Country by Country Sample</th>
<th>Positive Profits Only, Country by Country Sample</th>
</tr>
</thead>
<tbody>
<tr>
<td>Estimate of a 35 percent country by country minimum tax</td>
<td>$109 billion</td>
<td>$169 billion</td>
</tr>
<tr>
<td>Assigning all havens (defined as effective tax rate $&lt; 10%$) the world average profit/employee ratio</td>
<td>$78.8 billion</td>
<td>$120 billion</td>
</tr>
<tr>
<td>Removing tax elasticity and reallocating existing profits accordingly</td>
<td>$101 billion</td>
<td>$138 billion</td>
</tr>
</tbody>
</table>

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)

Bigger Issues
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