Do Multinational Firms use Tax Havens to the Detriment of Other Countries?

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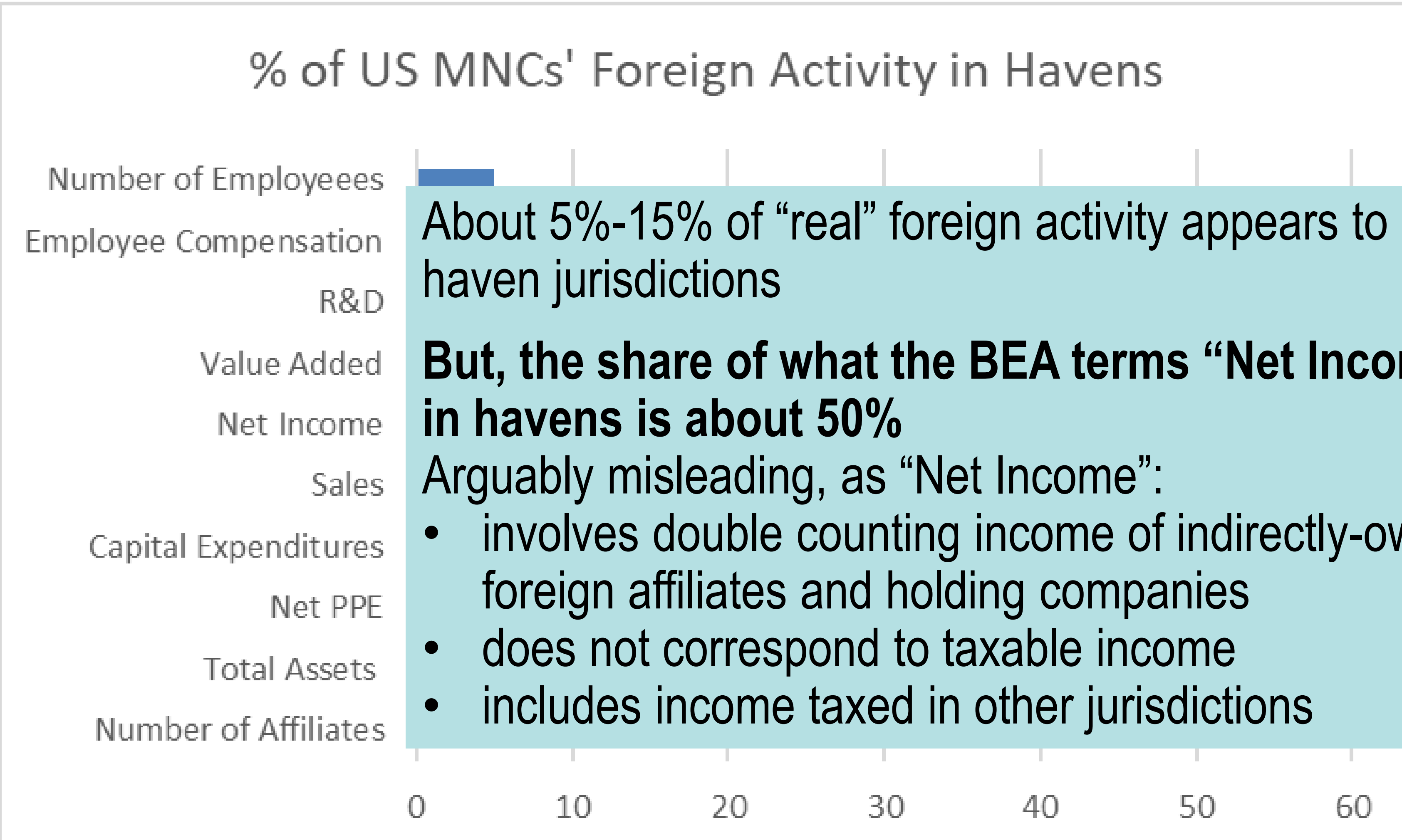
Share of US MNCs’ Foreign Activity in Havens



About 5%-15% of “real” foreign activity appears to be in haven jurisdictions

But, the share of what the BEA terms “Net Income” in havens is about 50%

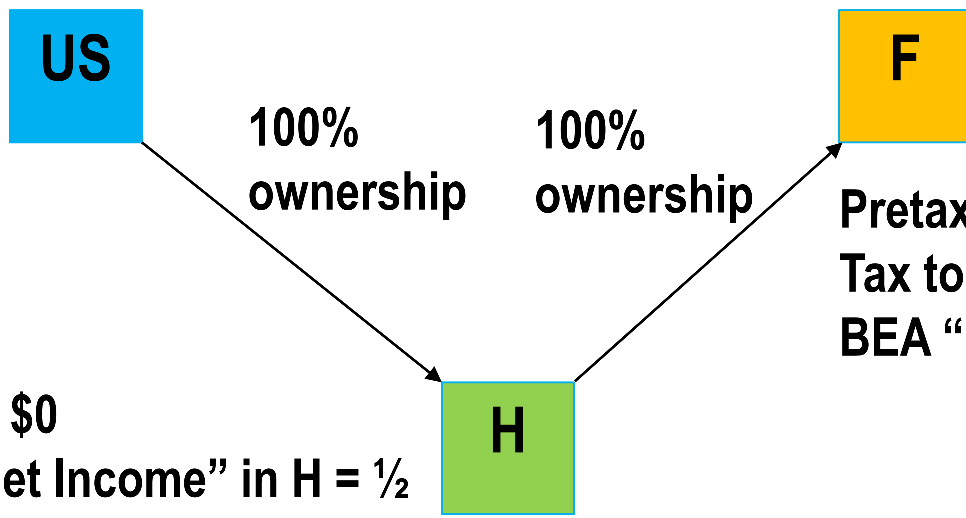
Arguably misleading, as “Net Income”:

- involves double counting income of indirectly-owned foreign affiliates and holding companies
- does not correspond to taxable income
- includes income taxed in other jurisdictions

Source: BEA, havens defined as in Dharmapala and Hines (2009)

Share of US MNCs' Foreign Activity in Havens

Blouin and Robinson (2019): clarify how the BEA concept of "income from equity investments" leads to double counting



Pretax profit = $100
Tax to F = $25
BEA "Net Income" = $75

Pretax profit in H = $0
Fraction of BEA "Net Income" in H = ½

Pretax profit = $0
Tax to H = $0
BEA: "income from equity investments" in F = $75
BEA "Net Income" = $75

Despite this double counting, haven and nonhaven affiliates are not as different in the BEA data as might be imagined

Nonhavens' Tools to Neutralize Havens

Nonhavens can neutralize MNCs' use of havens (e.g. using CFC rules)

A

20% tax
Income: \$50
Pays \$10 tax

No income shifting

B

20% tax
Income: \$50
Pays \$10 tax

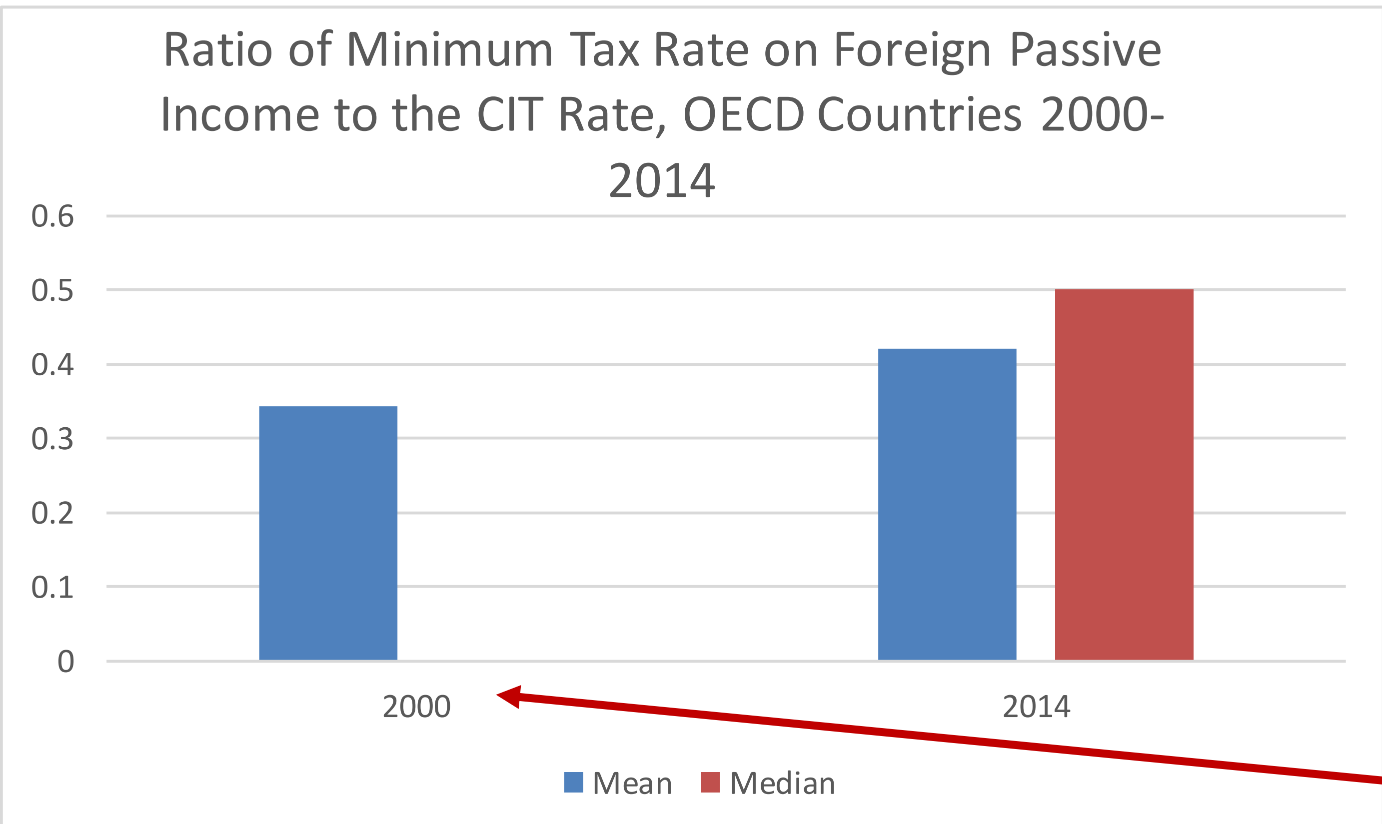
H

0% tax
Earnings: \$0

CFC rule: MNC's residence country taxes passive income reported in low-tax jurisdictions e.g. those with tax rate < 10%
→ minimum tax rate on foreign passive income of 10%

Nonhavens' Tools to Neutralize Havens

- The use of these types of rules has grown markedly
  - e.g. can infer residence countries' minimum tax rates on foreign passive income from CFC rules



Median = 0 in 2000

Impact on the Welfare of Nonhavens

- Why are these existing tax law tools not used (even) more extensively?
- At least two possibilities:
  - Collective action problem:
    - CFC rules benefit other nonhavens by discouraging foreign-to-foreign shifting
  - MNCs' haven activity benefits nonhaven countries
    - Enables tax discrimination between mobile and non-mobile firms
    - "If tax havens did not exist, it would be necessary to invent them"

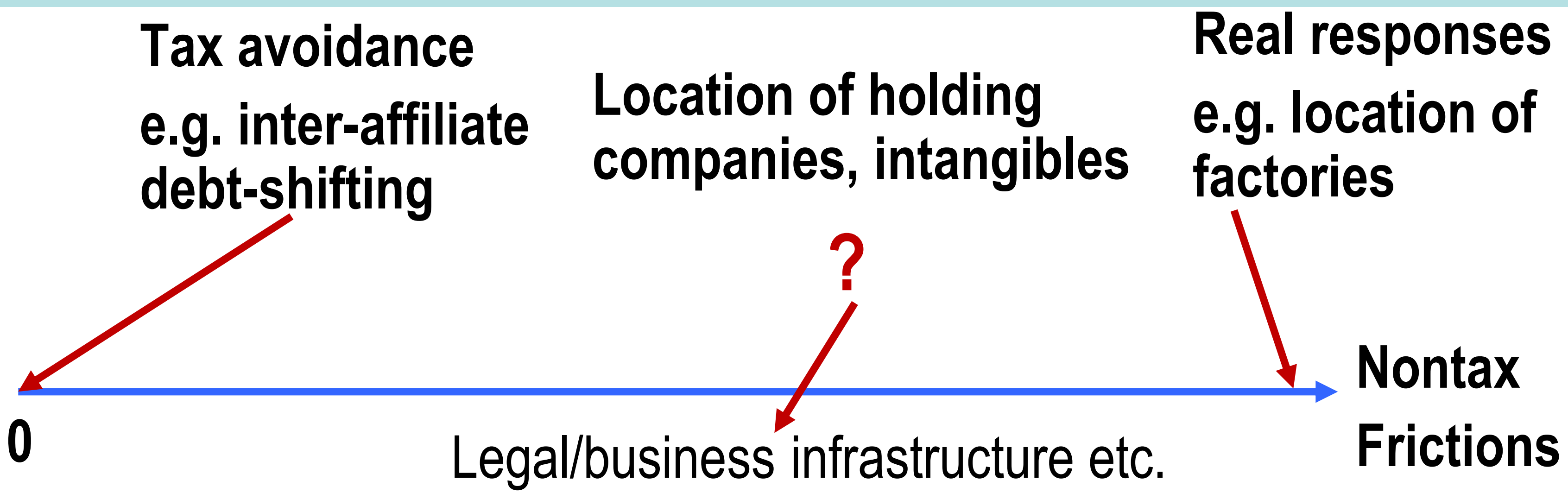
MNCs' haven use appears to be in the interest of nonhavens, at least as those interests are construed by their political systems

- **But may reflect political distortions (lobbying etc)**

Conceptualizing Profit Shifting to Havens

- Tax avoidance is constrained by:
  - Tax law
  - Costs of tax planning
- Behavioral responses are constrained by **nontax frictions**

While holding companies are disproportionately in havens, many are in nonhavens → nontax factors are important



Summary

- The evidence is consistent with MNCs' use of havens as locations for holding companies, financing and IP
  - But, there is evidence of significant frictions limiting MNCs' haven use
    - A substantial fraction of MNCs have no haven affiliates
  - Aggregate data seems to mechanically over-state MNCs' haven use
- Nonhaven countries have available powerful tax law instruments to neutralize MNCs' haven use
  - Thus, MNCs' haven use is facilitated by the laws of nonhaven countries
- The growing importance of legal and business infrastructure suggests rethinking the distinction between "tax avoidance" and "behavioral responses to taxation"