

Taxing Multinational Companies in the 21st Century

In a new book titled *Tackling the Tax Code: Efficient and Equitable Ways to Raise Revenue*, The Hamilton Project offers a range of detailed proposals by leading economists and other experts for better tax policies that can raise revenue in a progressive and growth-friendly manner. In one chapter, Kimberly Clausing of Reed College proposes several reforms to improve the taxation of multinational companies.

Specifically, Clausing's proposal would:

- Immediately **increase the corporate tax rate**, strengthen the global intangible low-taxed income (GILTI) minimum tax, and repeal the foreign-derived intangible income (FDII) deduction.
- In the longer run, pursue a **formulary approach** to the taxation of international corporate income.

Issue Overview

- **Policymakers currently face a trade-off between maintaining a competitive corporate tax regime and raising adequate revenue from corporate income.** Lowering corporate tax rates can attract international economic activity but also diminish the degree to which corporate income can serve as a revenue source.
- **Recent changes in international corporate taxation implemented through the Tax Cuts and Jobs Act of 2017 (TCJA) sacrificed large amounts of corporate tax revenue without improving the international competitiveness of U.S. corporations or the desirability of producing in the United States.** The TCJA also failed to address profit shifting and the incentive to move business activity offshore.
- **There are targeted reforms of the current system that could raise revenue and improve incentives to operate in the United States**, including a strengthened GILTI minimum tax.
- **Taxing a share of global income through formulary apportionment would protect both international competitiveness and the corporate tax base.** Instead of attempting to determine how much profit is generated in each country, formulary apportionment would tax the company based on its global income, assigning a fraction of its global income to the U.S. based on sales or other formula factors.

The Challenge

The core challenge in taxing multinational companies is one of competing priorities: maintaining competitiveness for international economic activity and protecting the corporate tax base as a revenue source. This trade-off is imperative for policymakers to address; with approximately 70 percent of U.S. equity income going untaxed, strengthening the taxation of corporate income offers significant revenue potential.

Profit shifting and offshoring pose further challenges. Raising the domestic corporate tax rate relative to rates abroad encourages international profit shifting or moving production overseas, thereby eroding the corporate tax base. Allowing companies to offshore profits to the most lightly taxed jurisdictions can similarly weaken the corporate tax base.

The Path Forward

Clausing proposes several policy options that can be enacted immediately without comprehensive changes in the current tax code, as well as options to be pursued over a longer time horizon. In the short-run, policymakers can:

- **Increase the corporate tax rate** to 28 percent. Increasing the corporate rate would raise corporate tax revenues by \$700 billion over one decade.
- **Modify the GILTI minimum tax** to become a per country minimum at three-quarters of the U.S. rate or a global minimum tax at the U.S. rate, in either case removing the 10 percent return on foreign assets exemption. Strengthening the GILTI in this way would reduce the incentive for profit shifting and lessen domestic corporations' sensitivity to non-haven foreign tax rates.
- **Repeal the FDII deduction** to eliminate the incentive to offshore assets that the TCJA introduced.

In the medium-run, pursuing a formulary apportionment approach to the taxation of multinational corporate income can reconcile competing priorities to remain internationally competitive while also protecting the corporate tax base. Under formulary apportionment:

- **A multinational company is taxed based on its global income**, rather than separately accounting for incomes in each country in which it operates.
- **A sales-only formula taxes a company's global income based on the U.S. fraction of global sales.** Thus, the U.S. corporate tax base would be the product of a company's global income and the share of its global sales made to domestic consumers.
- **The implementation process is complex and would benefit from international coordination.** Policymakers should strive to build consensus with other countries as they reform the international corporate tax regime.

Improving corporate income taxation offers promising revenue-raising potential for the U.S. economy. While formulary apportionment represents an effective medium-run strategy that could both maintain international competitiveness and preserve the corporate tax base, there are also short-run actions policymakers can take to strengthen corporate income taxation within the framework of current law.

About the Author

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