Are Worldwide Tax Systems Disadvantageous for Resident Firms Compared with Territorial Tax Systems?

Discussion by Ken Klassen
Overview

• I like the paper and particularly like the efforts to model the systems

• Outline:
  1. The importance of the research
  2. The challenges of modeling the complexity
  3. The challenges of estimating the effects
1. Importance of the Topic

- Much discussion of international tax systems effects on global businesses, country economies, tax revenues.
- “Governments risk ‘global tax chaos’ as they chase dwindling revenues from multinational companies unless the international tax regime is radically overhauled” —G20 Report
Ongoing Debate

• There continues to be much debate in the U.S. over the
  – need for,
  – costs of,
  – benefits of, and
  – winners vs. losers under reform that implements a territorial system
2. Challenges of Modeling

• Paper models the earning capabilities of multinationals
• Applaud the effort!
• Complex environment
2. Challenges of Modeling

• Assumption
  – Equality of after-tax accounting returns worldwide

• Included
  – Withholding taxes
  – Cross crediting
  – Allocation of domestic income for FTC
  – Income shifting
2. Challenges of Modeling

• Excluded
  – Deferral
  – Cost of shifting/allocation
  – Production function or asset allocation strategy
  – Withholding taxes from cross-country after-tax return equality
Terr Model—Another take

• Equilibrium for domestic companies
  \[ r^* \]

• Equilibrium for territorial-domiciled MNC
  \[
  r_T = r^* \left( 1 - a_H \omega_H - a_L \omega_L \right)
  + a_0 R_0 S_0 \left[ \text{shifting benefit} \right]
  + a_H R_H S_H \left[ \text{shifting benefit} \right]
  \]
Terr Model—Another take

- Lacking costs of shifting, \( S_j = 1 \)
- Simplifies to
  \[
  r_T = r^* \left( 1 - a_L \omega_L \right) + \left( a_0 R_0 + a_H R_H \right) \text{[shifting benefit to L]}
  \]
- All income is reported in \( L \): tax paid is \( \tau_L \) on all income + \( L \) withholding tax
WW Model—Another take

• Worldwide system is complex with FTC
• How I think about it:
  \[ r_{ww} = a_0 r^* + a_H R_H S_{H0} (1 - \tau_0) \]
  \[ + a_H R_H (1 - S_{H0}) (1 - \tau_H) + a_L R_L (1 - \tau_L) \]
  \[ + \text{Repatriation tax} \rightarrow \text{FTC} \]
• If successful in cross-crediting etc., \( \tau_{H,L} \rightarrow \tau_0 \)
WW Model—Another take

- For excess credits (average low FTR):
  \[ r_{WW} = (a_0 + a_H + a_L) r^* + a_H R_H S_{H0} (\tau_H - \tau_0) \]

- With any shifting, this is better than domestic only

- This is always less than the territorial return except for extremely large \( \omega \)
Modeling Overall

- Tough to model in a complex environment
- Intuitive results are that
  - territorial is better than domestic, especially with shifting
  - worldwide cannot be better than territorial without deferral, and then can only equal
- Depending on FTC modeling, this can be shown
Modeling Overall

• More broadly, the world is at rest
• Can one change to territorial without other changes?
  – Paper uses this point to argue for hypothesis H3, though not modeled
  – U.K. introduced more rigorous CFC/accrual rules shortly after their switch
3. Challenge of Estimation

• The world is at rest
• Can one perform cross-sectional tests to examine a policy change?
• Even changes tests are more cross-sectional than time-series
• What conclusions can be drawn?
Basic Analysis Structure

• Panel test with some countries switching from WW to Territorial (no one goes back)
  – Good quasi-experimental setting
  – Would like some jurisdictions to go back or could mask time series effects
Empirical Testing

• Very interesting dataset with LOTS of observations
• Carefully performed analysis
• Strong $t$-statistics
• Harder to assess economic significance
Empirical Tests — Challenges

• U.S., U.K., Japan WW during (mostly) whole sample period
  – Account for almost 60% of sample
  – Results weaker without U.S. (coeff. and t-stat)
  – Switches regression should exclude Japan and U.K. also

• Authors do not claim causation, but…
Empirical Tests—Suggestions

- Include WW main effect
- Statutory rate is strongly negatively related to returns
- Canada never had a WW system
Conclusion

• Important subject and a very ambitious project
• Highly value the analytic front half
• Challenges lie ahead to get to the answer that everyone would like to know.