Issues of Justice in Taxing Corporate Profit

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Two broad questions

- Is the incidence of tax on corporate profit fair …

  … or can we say what tax would be fair?

- Is the consensus allocation of taxing rights amongst countries fair …

  … or what would be fairer?

Economics v Philosophy: where to start?

- Cannot make welfare comparisons between real individuals and legal persons like companies

- Prior question in considering justice and fairness:

Which real individuals bears the effective incidence of a tax on corporate profit?

- Only then could we consider comparisons of inter-personal welfare
  - Horizontal equity, progressivity, etc

Isn't incidence generally ignored?

- Arguably yes, in much the optimal tax literature
  - Taxes on labour income typically assume incidence is on employee
  - Tradition of Ramsey typically assumes incidence of tax on sales of goods is on buyer
- But particularly key in tax on corporate profit
  - Though still ignored in much of the debate

Two extreme (and opposite) examples of incidence of on corporate profit

1. Tax solely on economic rent
   - Then behaviour in maximising post-tax economic rent = behaviour in maximising pre-tax economic rent
   - i.e. no change in behaviour, no change in prices, in any market in which business operates
   - So incidence on business owners

2. Tax on profit from capital in small open economy
   - Post-domestic tax fixed on world markets
   - Domestic tax raises pre-tax rate of return
   - So incidence is NOT on business owners

Is incidence on labour or capital?

Harberger (1962)

- And subsequent theoretical and empirical literature
- But would rather know whether it is progressive, and preserves horizontal equity
  - Evidence on this varies, e.g. Fuest et al (2018) v Nallareddy et al (2021)
  - A vital task for future research

Why tax corporate profit?

- Back-up for personal income tax, for
  - Labour income, and
  - Capital income?

Sheltering either form of income in a corporation without tax on accrual unlikely to be fair

- What does this imply for the form of the tax on corporate profit
  - As similar as possible to personal income tax?

Should all capital income be taxed at the same rate?

Yes …

- … if there is a common risk-adjusted rate of return on all forms of capital income
- Eg. In a small open economy, and taxes levied on a residence-basis

Perhaps no …

- … if a Ramsey type approach is more appropriate, with variation in elasticity of demand for funds in different sectors

More specifically …

- Corporation taxes tend to levied on a “source” basis, where activity takes place
- Income taxes are predominantly levied on a “residence” basis, where the owner resides
- These have very different properties / elasticities
  - Corporation tax a poor proxy for income tax

What about global minimum tax?

- G20/OECD agreement, July 2021 (modified December 2021)
- Broadly agreed a global minimum tax of 15%
  - though actually on “excess profit”, not all profit
- Should affect the equilibrium world rate of return (abstracting from risk)

- What about the incidence of the tax in a small open economy?
  - Still take the world return as fixed, so unilateral changes still affect only the local pre-tax rate of return

Allocation of taxing rights?

- Amongst governments: what would be fair / just?

- In relation to location of some element of the company?
  - Residence of owners (who would bear personal income tax)?
  - Residence of HQ / parent company?
  - Location of real productive activities?
  - Location of third-party customers?

- Or with aim of reducing global inequality?
  - But why use tax on corporate profit as the instrument?

What about global minimum tax?

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- Qualified Domestic Minimum Top-up Tax (QDMTT) (December 2021) is transformative in allocation of the minimum tax amongst countries
- Tax competition + profit shifting means that many low income countries raise little from taxes levied on multinational profit
- Creating a floor of 15% of “excess profit” must be better than a floor of zero
  - No point in offering incentives below this (subject to some caveats)
  - And incentive to shift profit much reduced

Conclusions

More questions than answers …

- Cannot make philosophical judgements about corporate tax and justice without assuming something about incidence
- But incidence likely to vary across markets, and we have no real consensus
- Not clear why tax on corporate profit should be a preferred instrument to redistribute between countries