Issues of Justice in Taxing Corporate Profit

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Beveridge 2.0: Tax Justice Symposium
May 3, 2022
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 be 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?

- 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