

# Competing for Companies?

A Jurisdictional Analysis of Multinational Corporation Tax

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# Voting with the Feet

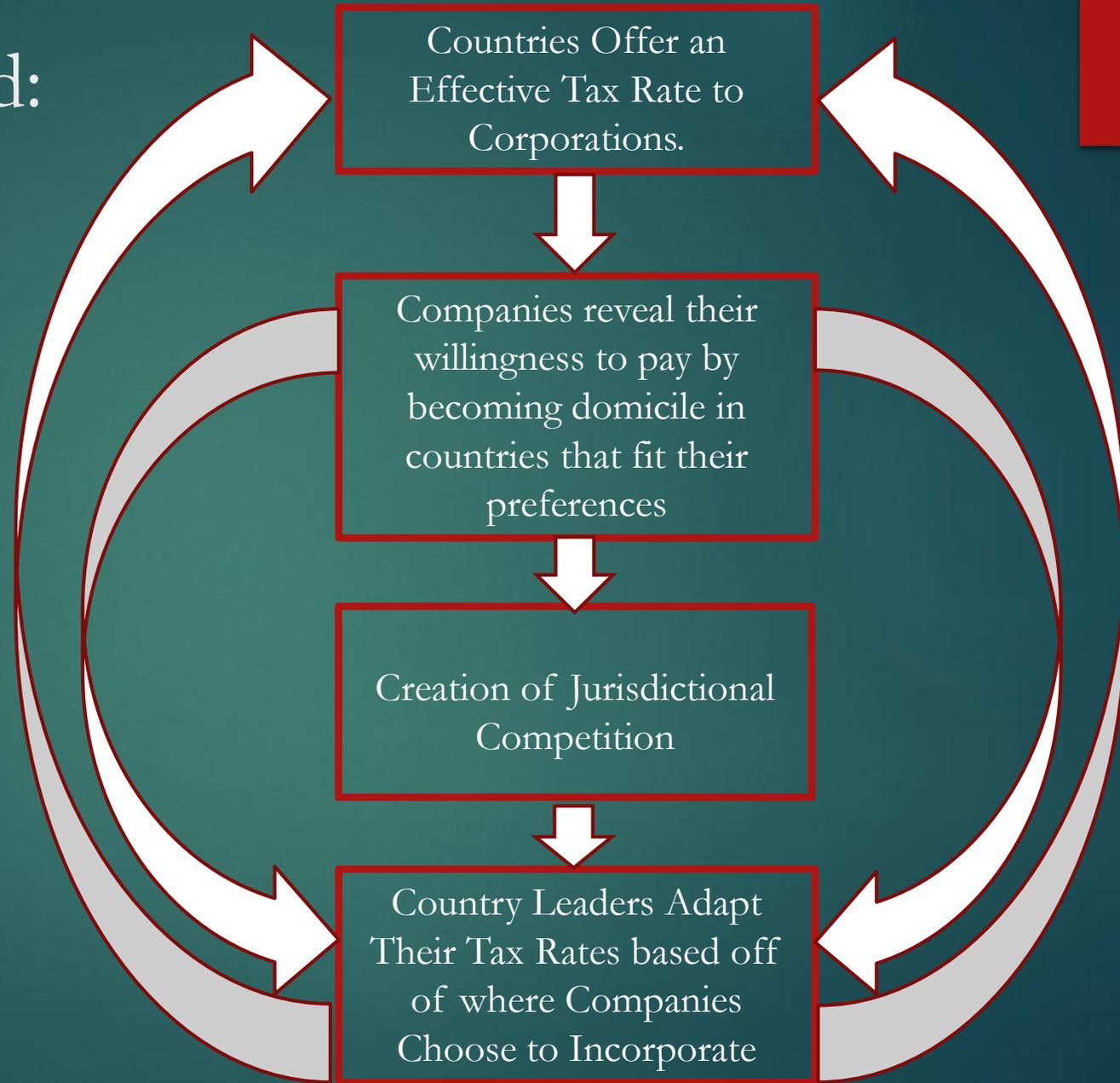
- ▶ Tiebout argued that at a more local level, where municipalities had a better idea of their citizens wants and willingness to pay for services, thus creating a competition amongst the municipalities for the consumer voter.
- ▶ The same argument applies to multinational corporations and their chosen domicile for tax burden – or “*voting with one’s letterhead.*”



# Tiebout Conditions adapted for Corporations:

1. There are many “communities” or jurisdictions for the company to choose from.
2. Relatively low costs associated with moving – because entire operations are not moving, only legal status moves.
3. Public goods do not spill over in terms of benefits/costs from one community to the next.

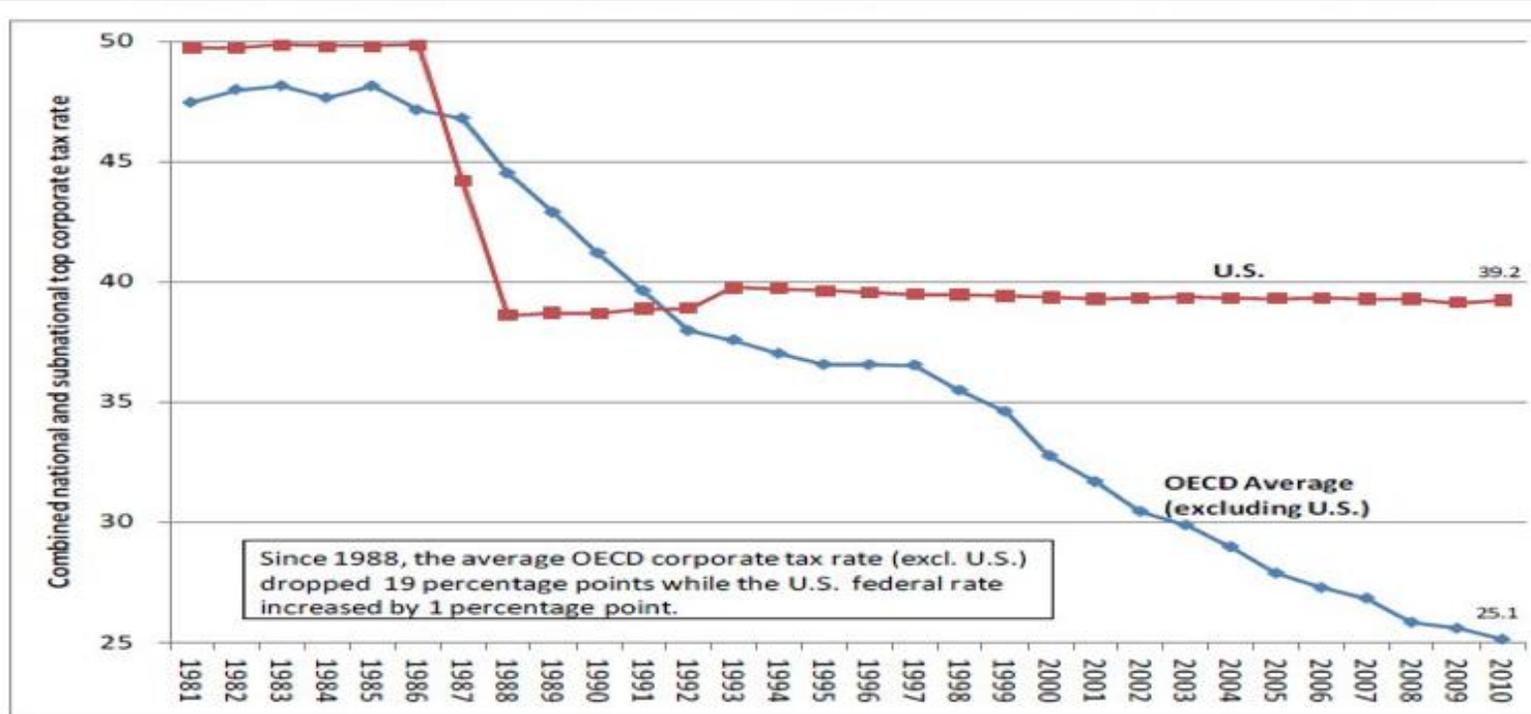
# Tiebout Model Adapted:



# What is Inversion?

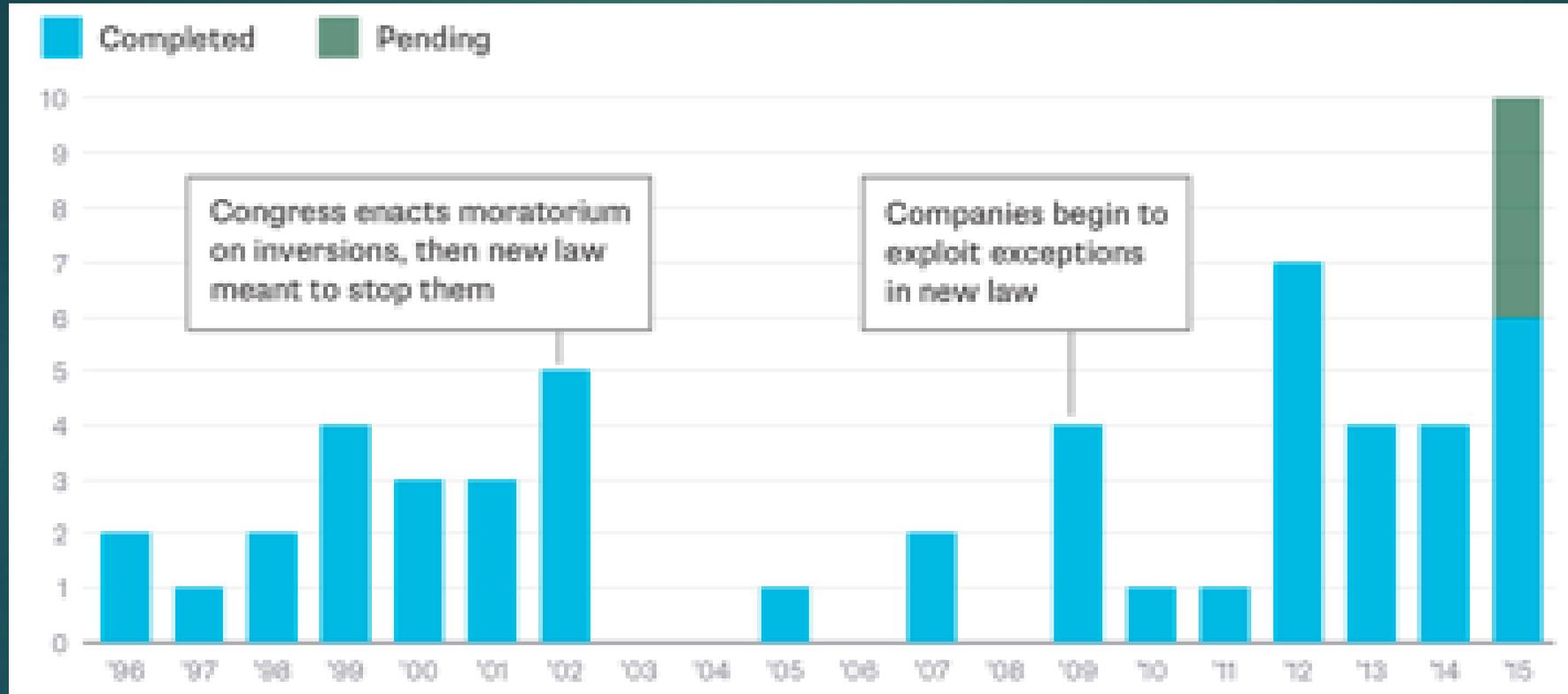
- ▶ Corporate inversion is one of the many strategies companies employ to reduce their tax burden. A company can re-incorporate abroad by having a foreign company buy its current operations. Assets are then owned by the foreign company, and the old incorporation is dissolved.
- ▶ Additionally, inverted companies continue to enjoy the protection of patent protection and contract enforcement in the United States.
- ▶ Even though there is a change of address involved, the executives and employees do not have to move with the company.

# How do we fare?



Source: OECD tax database; 2010 average includes reported tax rates for three members that acceded to the OECD in 2010 that are not yet included in the tax database. The U.S. rate is based on the 35-percent federal tax rate and average state taxes of 6.47 percent, which are deductible from federal taxes.

# How do we Fare Cont'd:



Country	1995 Corporate Effective Tax Rate %	Difference %	# of Companies Inverted Between '95 - '05	2005 Corporate Effective Tax Rate %	Difference %	# of Companies Inverted Between '05 - '15
United States	32.5	-	-	35	-	-
United Kingdom	33	-0.5	1	30	-5	6
Ireland	38	-5.5	4	12.5	-22.5	8
Bermuda	0	-35	8	0	-35	2
Luxembourg	33	-0.5	0	22.88	-12.12	1
Netherlands	35	-2.5	1	31.5	-3.5	3
Other Countries			6			9

# Breaking it down:

- ▶ 51 U.S. companies have reincorporated in low-tax countries since 1982, including 20 since 2012. However, that is an underestimate of the actual effect of a high corporate tax rate in the US. Companies employ strategies that are akin to inversion without actually reincorporating.

So the real question is:

- ▶ **Why do companies incorporate in the US?**
- ▶ **Answer: More Efficient Solution than Inversion**

# Examples of Tax Avoidance:

- In 2013, Apple was under investigation for somehow legally avoiding to pay nearly **\$45 BILLION** in tax over the past 4 years. Apple used the “check the box” loophole in the tax code, sending a significant amount of its profits and dividends overseas where they pay a ridiculously low tax rate.
- In 2010, G.E. reported worldwide profits of \$14.2 billion, \$5.1 billion of the total was attributable from its operations in the United States. G.E. did not pay any taxes, instead G.E. claimed a tax benefit of \$3.2 billion!
- G.E. has been extraordinarily successful due to the aggressive strategy that mixes fierce lobbying for tax breaks with innovative accounting that enables it to concentrate its profits offshore.
- In 2014, **fifteen** Fortune 500 companies paid **NO** taxes on a collective 23 billion dollars in profits. This has the same effect as inversion - without even changing the letterhead.

# Why isn't the US reducing its corporate tax rates?

- ▶ Two conditions must hold in order for inter-jurisdictional competition to motivate legislators to take the preferences of general members of the “community” into account:
  1. Individuals/companies must have the knowledge and means to actively move from less preferred to more preferred jurisdictions.
  2. Lawmakers must have a vested interest in attracting or maintaining population within the jurisdiction.
- ▶ However, individual lawmakers gain more by offering targeted special benefits toward specific firms.
- ▶ Therefore there is no general reduction in tax rates, instead cronyism and misallocation of resources.

# References:

- ▶ The data that I am looking at comes from Fortune 500 companies since 1982.
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- ▶ Tiebout, Charles M. "A Pure Theory of Local Expenditures." *Journal of Political Economy* 64, no. 5 (1956): 416-24.

Thank You!!



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