Graphic detail

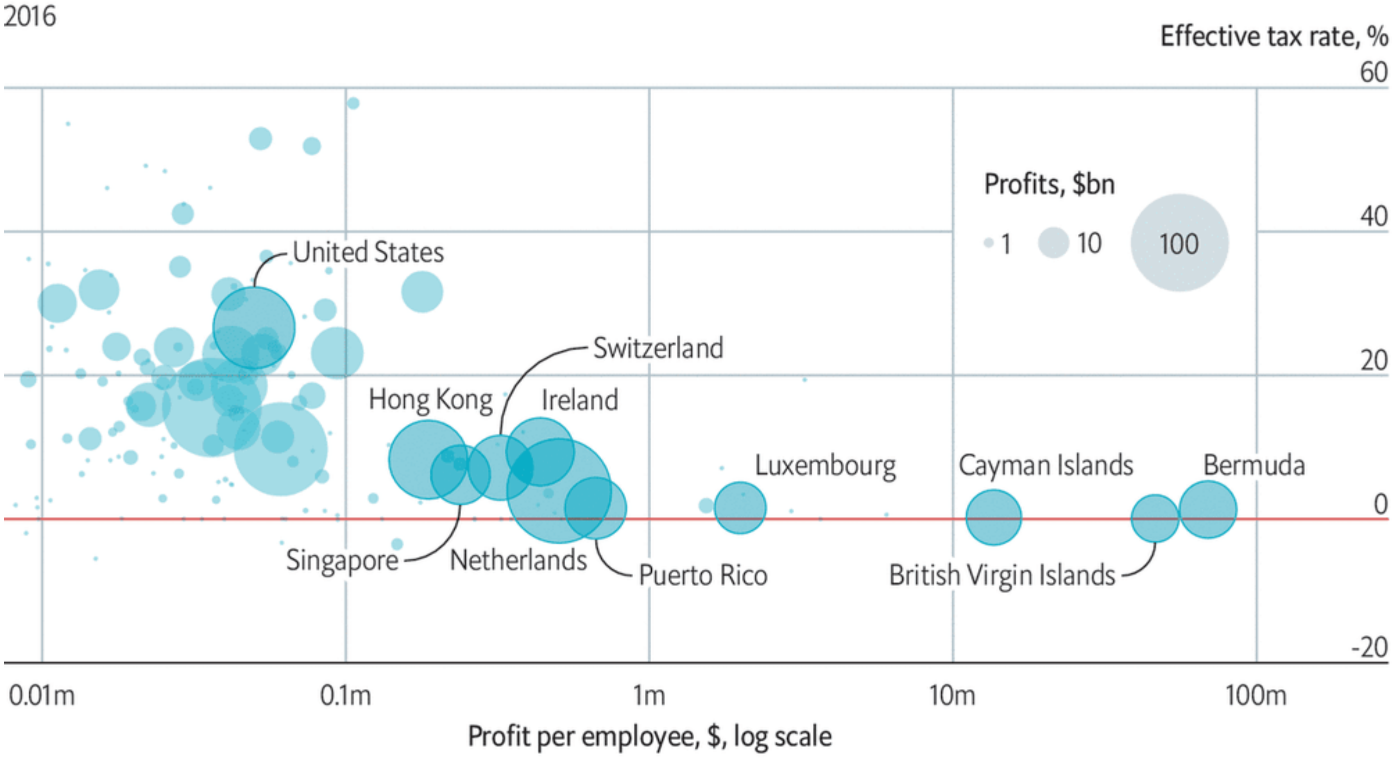
Daily Chart

Joe Biden hopes to stop American multinationals booking huge profits abroad

Given their love of tax havens, reform could be valuable

How low can they go

Multinational corporations, foreign profits by country
2016



Source: "Profit shifting of multinational corporations worldwide", by Javier Garcia-Bernardo and Petr Jansky, International Centre for Tax and Development working paper, March 2021

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corporate-tax rate, calling for an end to what she termed a “race to the bottom”. It is hard to quibble with that assessment. According to the Tax Foundation, a think-tank, average corporate-tax rates around the world have plummeted from 40% in 1980 to 24% in 2020. Tax havens such as the Cayman and British Virgin Islands, which offer bargain-basement rates to entice multinational companies, have led the way down. In the 1960s less than 10% of foreign profits earned by American multinationals (excluding oil companies) was booked in these low-tax jurisdictions; by 2018 that percentage had risen above 50%. By one estimate, America’s Internal Revenue Service (IRS) misses out on nearly $65bn in tax revenue a year because of profits booked in tax havens.

American tax rules often encourage such tax-dodging. In the 1990s, for example, the IRS began allowing companies to decide for themselves how to classify their foreign subsidiaries for tax purposes simply by ticking a box on an IRS form. This “check the box” rule, as it came to be known, was originally intended to cut red tape. Today it is one of the most widely used tax loopholes, allowing American firms to shift profits from high-tax countries to low-tax ones. After the introduction of the rule, profits booked in Ireland, which had slashed its corporate-tax rate from 32% in 1998 to 12.5% in 2003, shot from 5% of all (non-oil) pre-tax foreign profits to 15% in 2002. America now takes in less corporate tax as a percentage of GDP than almost any other country in the OECD.

Joe Biden, America’s president, hopes to fix this—and help finance an infrastructure bill worth more than $2trn in the process—by raising the federal corporate-tax rate (from 21% to 28% on domestic profits, and from 10.5% to at least 21% on foreign profits) and convincing other rich-world countries to do the same. This could prove difficult in a world where companies are increasingly footloose. Typically, firms are taxed in the jurisdictions in which they are legally domiciled, which creates incentives to move operations to places with lower rates. Tech companies, whose assets are primarily digital and can be easily moved, take full advantage of this. A report by Fair Tax Mark, a British tax-reform group, estimates that Silicon Valley’s six largest companies paid $155.3bn less tax between 2010 and 2019 than would be expected given the headline tax rate in America, attributing much of the difference to the use of tax havens. If agreed to, a global minimum rate would oblige companies to pay (to the countries where they are headquartered) the difference between the local

But the plan will work only if other countries sign up for it. That is a big "if". This week G20 finance ministers expressed support for the idea. But proposals to create such a global tax regime have been made in the past, only to fall apart. Those who profit from the current arrangement by keeping their tax rates low might well try to scupper reform.

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