
Is it unfair that some firms don't pay corporate income tax in Europe?

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Over the last few years that have been headlines criticising some large (mainly US) firms for not paying tax in Europe



One Direction paid more UK tax than Facebook

Luke Graham, special to CNBC.com
Friday, 13 Nov 2015 | 9:15 AM ET



Financial reports filed by One Direction reveal the pop band paid more corporation tax in the U.K. than social media giant Facebook.



This session

- 20 minute presentation
 - How does the current corporate tax system work?
 - Who bears the burden of corporate income taxes?
 - How do we assess “fairness” of a tax?
- 10 minutes in groups
- 20 minutes on presentations/discussion
- 10 minute wrap up

Group topics and presentations

1. The current tax treatment is “fair” – the US decides how to tax Starbucks, Amazon, Apple and other US firms on their worldwide income.
2. The current tax treatment is not “fair” – a fairer system would be what the EU is proposing, where companies are taxed based on where they sell their products.
3. You could have a “fair” tax system without having a corporate income tax.
4. You could not have a “fair” tax system without having a corporate income tax.

How does the corporate tax system work?

- Your mother gives you \$10 to open a lemonade stand
- You spend the \$10 on
 - lemons (\$1), sugar (\$1), a pitcher (\$3), cups (\$2), wages (\$3)
- You sell 50 cups at \$0.25
 - costs were \$0.20 per cup
 $50 * 0.20 = \$10.00$
 - income is $50 * 0.25 = \$12.50$
 - profits are income minus costs = \$2.50
 - which go back to your mum as a dividend
- If there is a corporate income tax at 40%
 - 40% of the profits go to the government
 - 40% of \$2.50 = \$1.00 has to be paid to the government



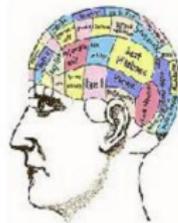
Current international system for taxing corporate income

- Based on the principle that profits are taxed in **the location where value is created**
 - This is called a **source-based** tax
- Problem: it can be difficult to determine the **source of profits**
 - in particular when profits arise from using intangible assets

Tangible Asset



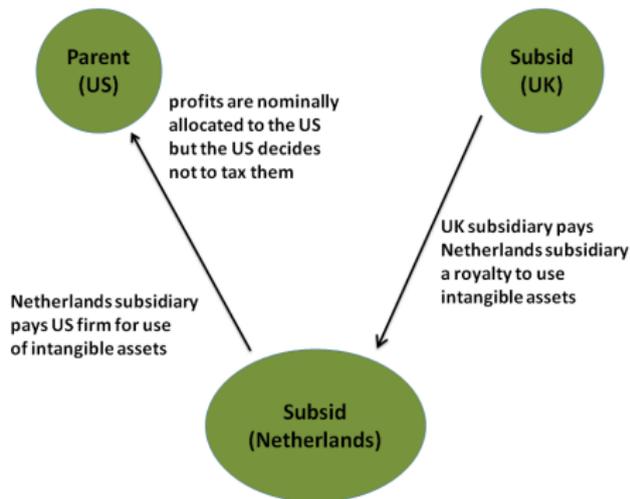
Intangible Asset



- tangible assets include: machinery, land, buildings
- intangible assets include: patents, trademarks, brand names

Why some firms pay so little tax in the UK?

- (very simplified) the US parent firm license it's intellectual property to a subsidiary in the Netherlands
- the UK subsidiary makes royalty payments to the Netherlands subsidiary
 - payment for use of intellectual property



How much should Starbucks pay?

- The current international tax system aims to tax profits at the **source where the profits arise**
- What is the source of Starbucks profits?
 - when I buy a cappuccino in Starbucks what am I paying for?
 - the machines?
 - the fact they ask my name and write it on the cup
 - the music they play? that they give me the free iTunes download?
 - were those things “created” at US headquarters, or in the UK branch?

Why did Facebook pay so little tax?

- Facebook paid all of its profits out to its workers
 - presumably the Facebook owners thought it was the workers who had all the good ideas that generated profits
 - would it have been more fair for the owners of Facebook to keep those profits instead of paying them to workers?
- Workers paid tax on these earnings
 - many will probably pay tax at 40%
 - if the firm had kept profits it would have paid 20%
 - if this is true then the UK got more tax receipts than if Facebook had retained the money as corporate profits

Who bears the burden of corporate income taxes?

- **Legal incidence**

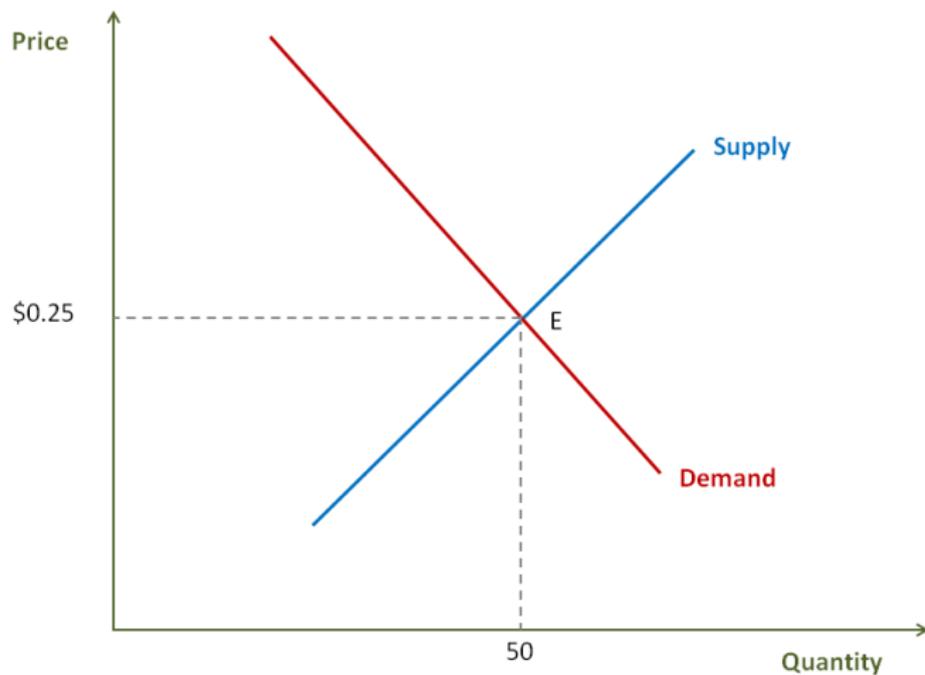
- legally “the firm” pays the tax to the Inland Revenue
- in fact firms pay most taxes in this sense

- **Economic incidence:**

- who is made worse off because of the tax
- firms can not bear the economic incidence of a tax, they can not be made worse off, only people can

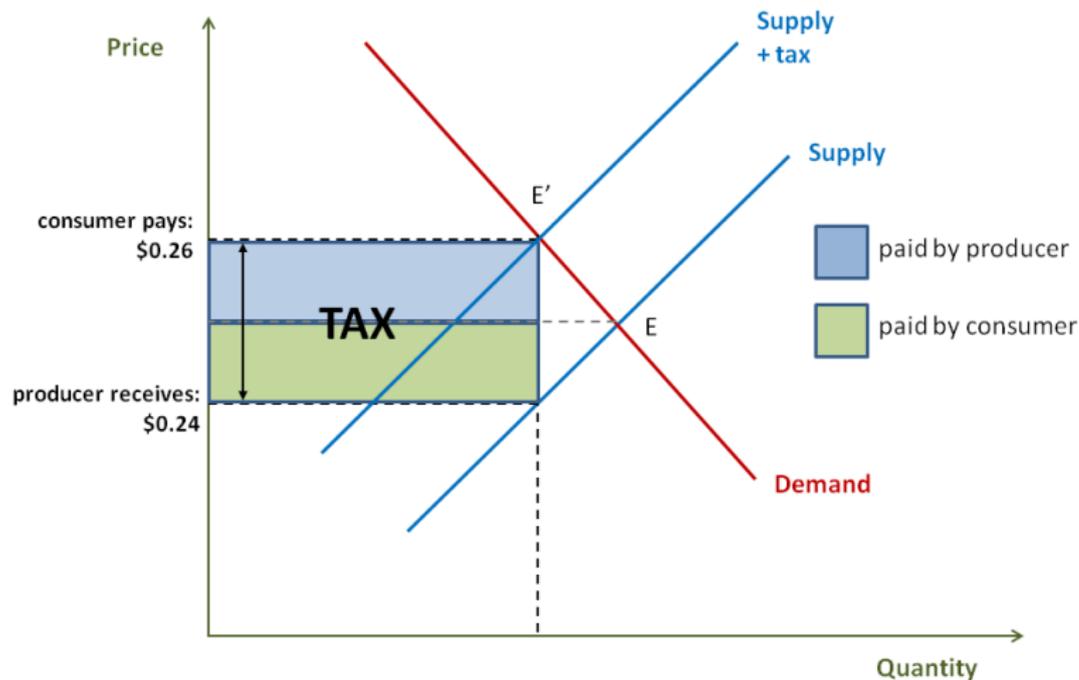
Who bears the burden of corporate income taxes?

The market for lemonade



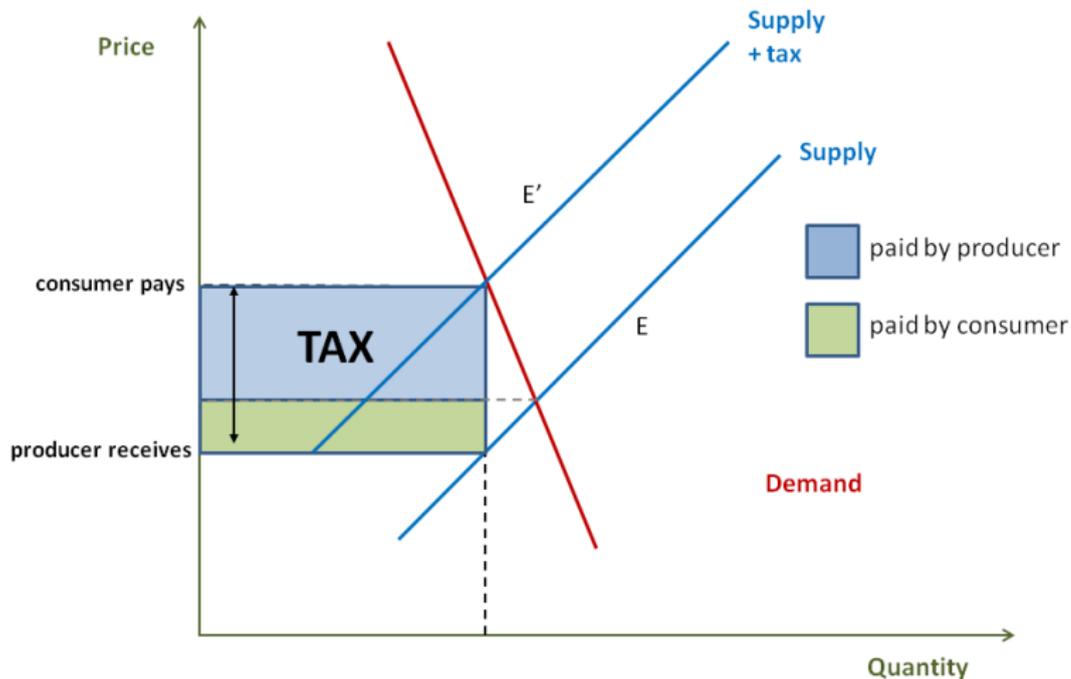
Who bears the burden of corporate income taxes?

Tax incidence in the market for lemonade



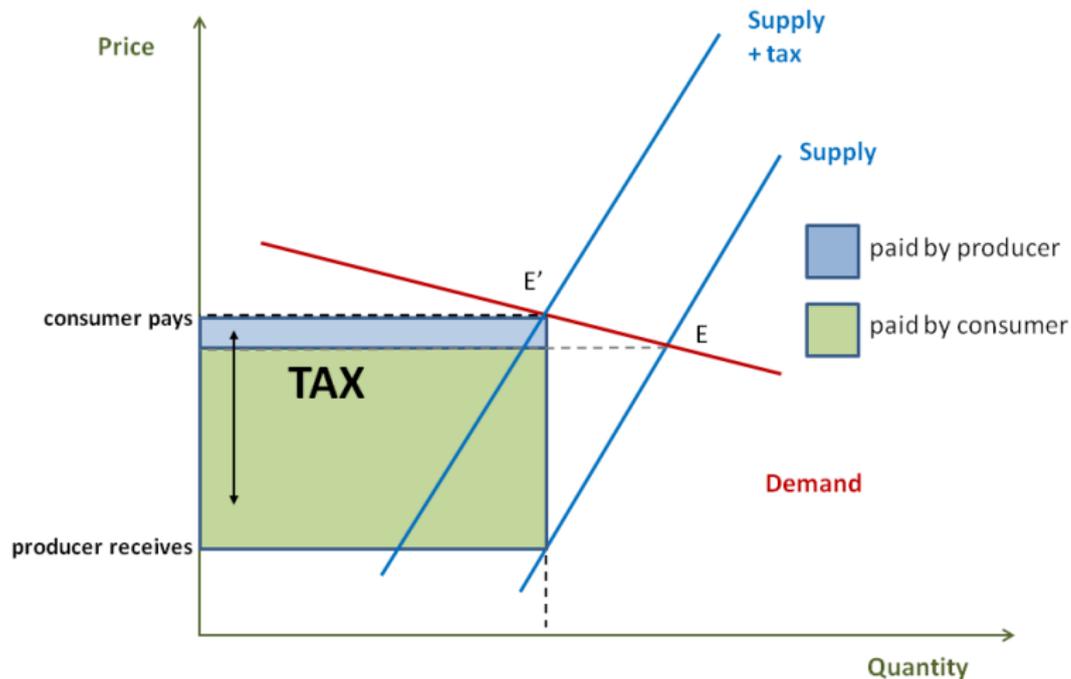
Who bears the burden of corporate income taxes?

Tax incidence with **less** price sensitive consumers



Who bears the burden of corporate income taxes?

Tax incidence with **more** price sensitive consumers



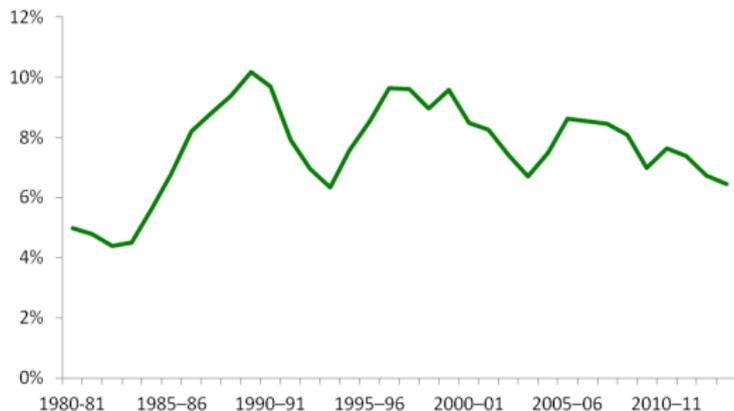
How do we assess “fairness” of a tax?

- “Fairness” is not a property of a specific tax
 - it is a property of a **tax (and benefit) system**
- “Fair” relative to what?
 - relative to your income?
 - relative to how much of publicly provided goods the firm uses?
 - relative to what competitor firms pay in tax?
 - relative to other “people”?

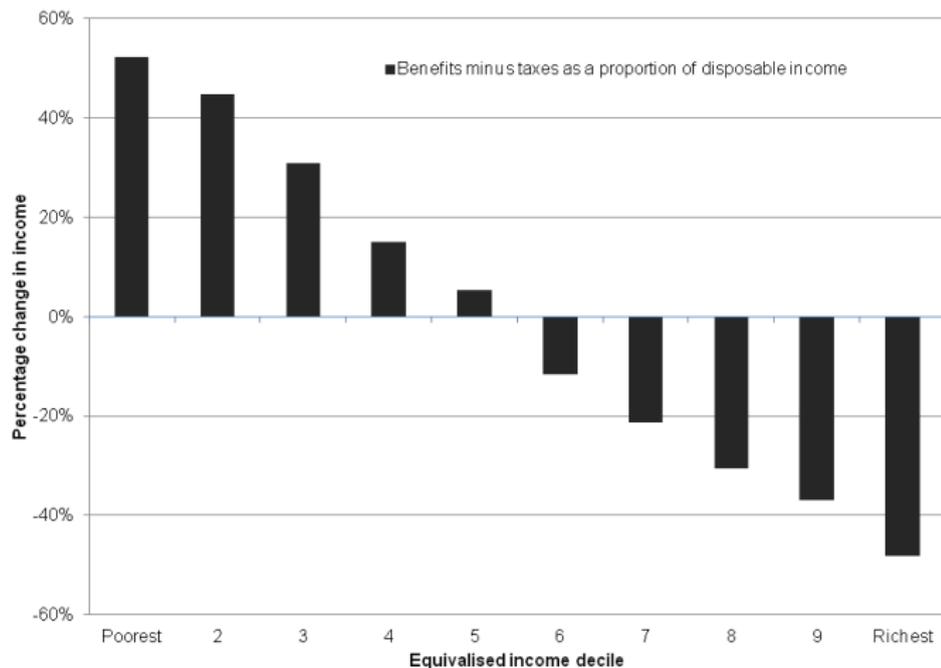
What is a “fair” share of tax?

- Revenue from corporate income taxes is about 7% of total tax revenue in the UK, it has been pretty stable over time

Corporate income tax revenues as a share of total tax revenues



Distributional impact of the UK tax and benefit system in 2009-10, excluding 'business taxes'



Adams and Browne, 2010, IFS

Open policy questions and topics of interesting ongoing economics research

- What are the efficiency and equity implications of different ways of taxing corporate income?
- Where should companies pay income tax? Is the principle of source based taxation the right one?
- What is the economic incidence of corporate income tax?
- What is a fair tax system? How do we trade off equity concerns with efficiency concerns?

Group topics and presentations

- 10 minutes to come up with key bullet points supporting your statement and prepare to make a 3 minute presentation
 1. The current tax treatment is “fair” – the US decides how to tax Starbucks, Amazon, Apple and other US firms on their worldwide income (source based taxation).
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- 4 x 3 min presentations (20 minutes) presentations/discussion
- 10 minute wrap up