International tax competition with rising intangible capital and financial globalization

by Vincenzo Quadrini and José-Victor Ríos-Rull

Discussion by: Fabrizio Perri
Minneapolis Fed

Carnegie Mellon University Tepper School of Business
SIMON SCHOOL OF BUSINESS UNIVERSITY of ROCHESTER
NEW YORK UNIVERSITY NYU STERN LEONARD N. STERN SCHOOL OF BUSINESS

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The question

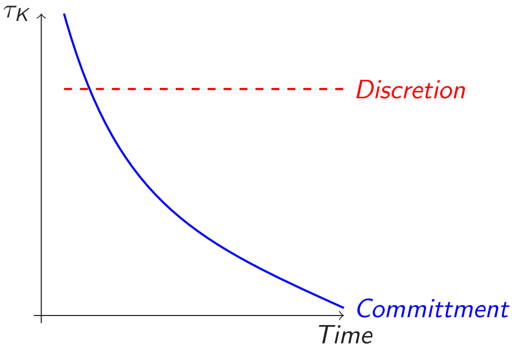
How do equilibrium capital taxes depend on structural features such as:

- Financial globalization?
- Multinational production?
- Share of intangible capital?

Discussion outline

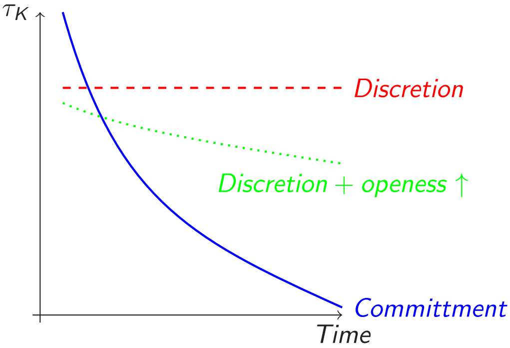
- Some context
- Quick summary
- Supporting evidence
- Some data

Theory: capital taxes in closed economy



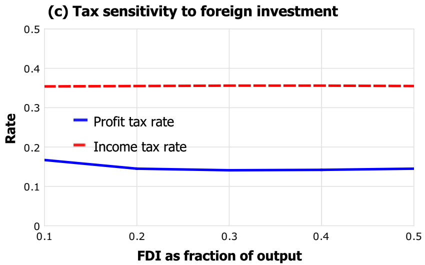
- With commitment τ_k goes to 0 in the long run
- With discretion govt. at time t perceives capital taxation at t to be non distortionary, thus it increases it
- τ_k positive and high in the long run

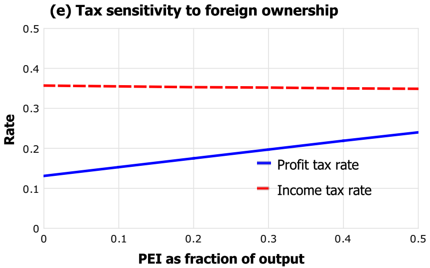
Theory: capital taxes in opening economies (Quadrini 2005)



- Open economy: threat of capital flight reduces the ability to tax (shifts left Laffer peak)
- As economy becomes more open (lower cost of investing abroad) equilibrium taxes fall
- Openness increases the elasticity of capital to taxes

Theory: capital taxes with growing multinationals (this paper)





- As multinational become more important, and their ownership more internationally diversified equilibrium τ_k increase!
- What's going on?

Some historical background

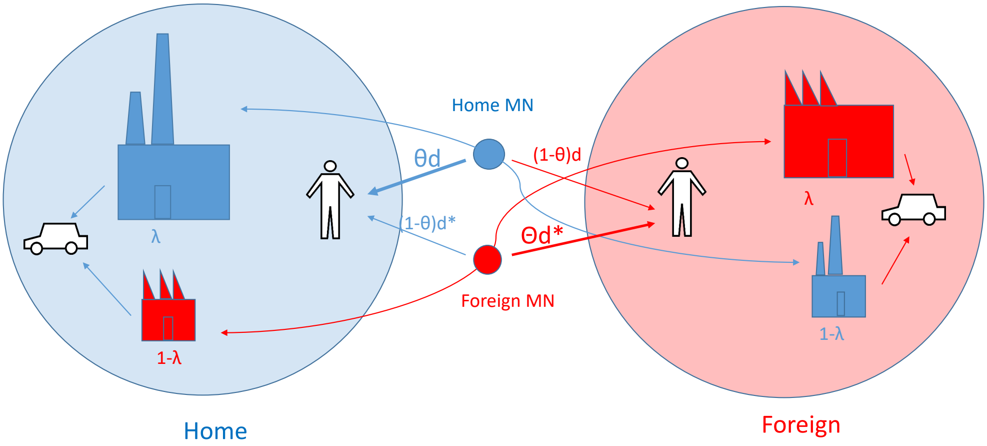
IS THERE A FUTURE FOR CAPITAL INCOME TAXATION?

by
Jack M. Mintz
Arthur Andersen Professor of Taxation
University of Toronto

ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT
Paris 1992

these taxes as having quite different impacts on the economy. The paper then suggests that some forces (e.g. capital flight) will encourage governments to shift away from capital income taxation while others (e.g. tax exportation) will have the opposite effect.

The economy



- Globalization modelled as more multinational production ($\lambda \downarrow$) and financial diversification ($\theta \downarrow$)
- Both changes increase incentive to tax through “Tax exportation”!

Endogenous taxes

- No cooperation
- No commitment
- Each govt. chooses $\tau(X)$, taking as given $\tau^*(X)$ and $\tau'(X)$
- Complicated fixed point in function space, authors solve for ss AND transition!!
- Because of higher incentive to “Tax exportation” with more globalization, higher capital taxes
- Intuition: globalization reduces the domestic cost of taxes and (in this context) does not affect much elasticities
- Takeaway: how exactly you model globalization matters!

Intangible capital and MNE

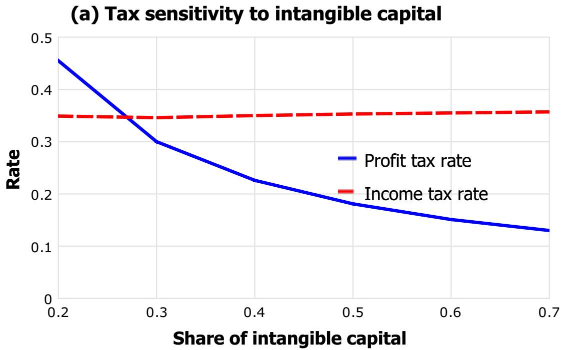
Insight of the paper

- It is not globalization per se but globalization + intangible capital

"MNEs own significant stocks of intangible capital (e.g., intellectual property, brands, blueprints) and have a presence in countries that vary widely in corporate tax rates. These characteristics allow MNEs to legally take advantage of differences in national tax regimes to shift profits from high- tax jurisdictions—such as the United States—to low- tax jurisdictions, such as Bermuda. Increasingly common profit-shifting practices include transfer pricing and complex global structuring related to intangible capital, in which an MNE effectively underprices intangible capital when "sold" from one of its entities in a high- tax jurisdiction to another of its entities in a low- tax jurisdiction or engages in a series of transactions among subsidiaries that are strategically located in order to reduce the MNE's effective global tax rate. For US MNEs, these strategies allow them to book earnings in low- tax foreign affiliates in ways that are disproportionate to the economic activity carried out in those affiliates"

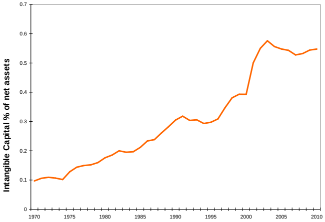
Guvenen,Mataloni,Rassier and Ruhl, 2022

The tax impact of more intangible capital

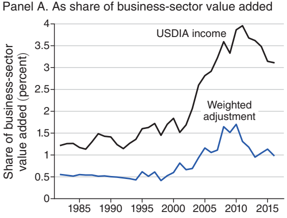


- Very large predicted decline in capital taxes!
- Intangible capital makes it easier for firms to book profits in lower tax jurisdictions
- Possibly interesting to explore interaction between intangible and globalization
- Conjecture: impact of intangible K on taxes much smaller in more closed economies

Intangible and tax shifting



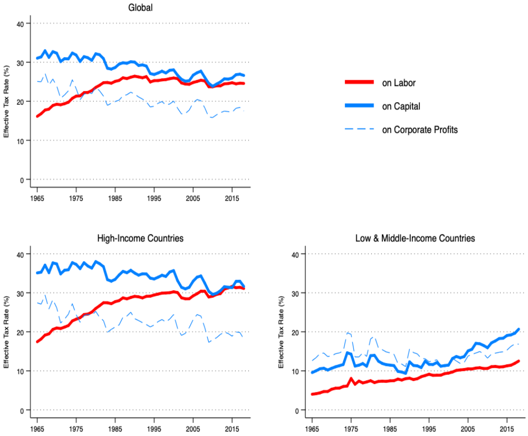
Falato and al (2022)



Guvenen et al (2022)

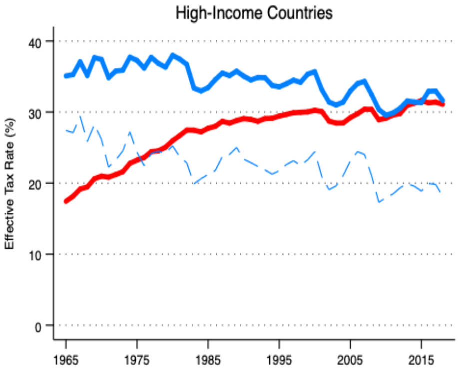
- Over 2000-2010 large increase in value of intangible and large increase in profits booked by multinationals in tax heavens!
- Support the view that intangible capital limits capital taxation

Recent data on tax rates



- Bachas,Fisher-Post, Jensen and Zucman (2022), extending Mendoza,Razin and Tesar (1994) across time and space

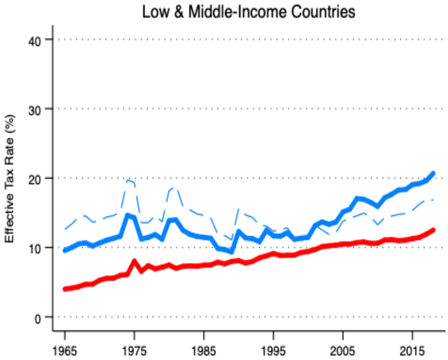
Recent data on tax rates



Remark 1

- Across developed countries τ_k declined, especially when compared to τ_L (20ppt)
- However most of the decline occurred before globalization and increase in intangible K!
- Possibly paper overestimates impact of intangible K on τ_K?

Recent data on tax rates



Remark 2

- In developing countries τ_k increased!
- Possibly consistent with tax exportation motives highlighted in this work

Conclusions

- Impressive theoretical and computational machine to assess the impact of various structural factors on equilibrium taxation in open economies
  - How you model globalization matters a great deal
  - Important complementarities between globalization and intangible K
  - Incentive to tax exportation are large
- Possibly take a look at recent tax data to refine quantitative findings