Stateless Income Changes Everything

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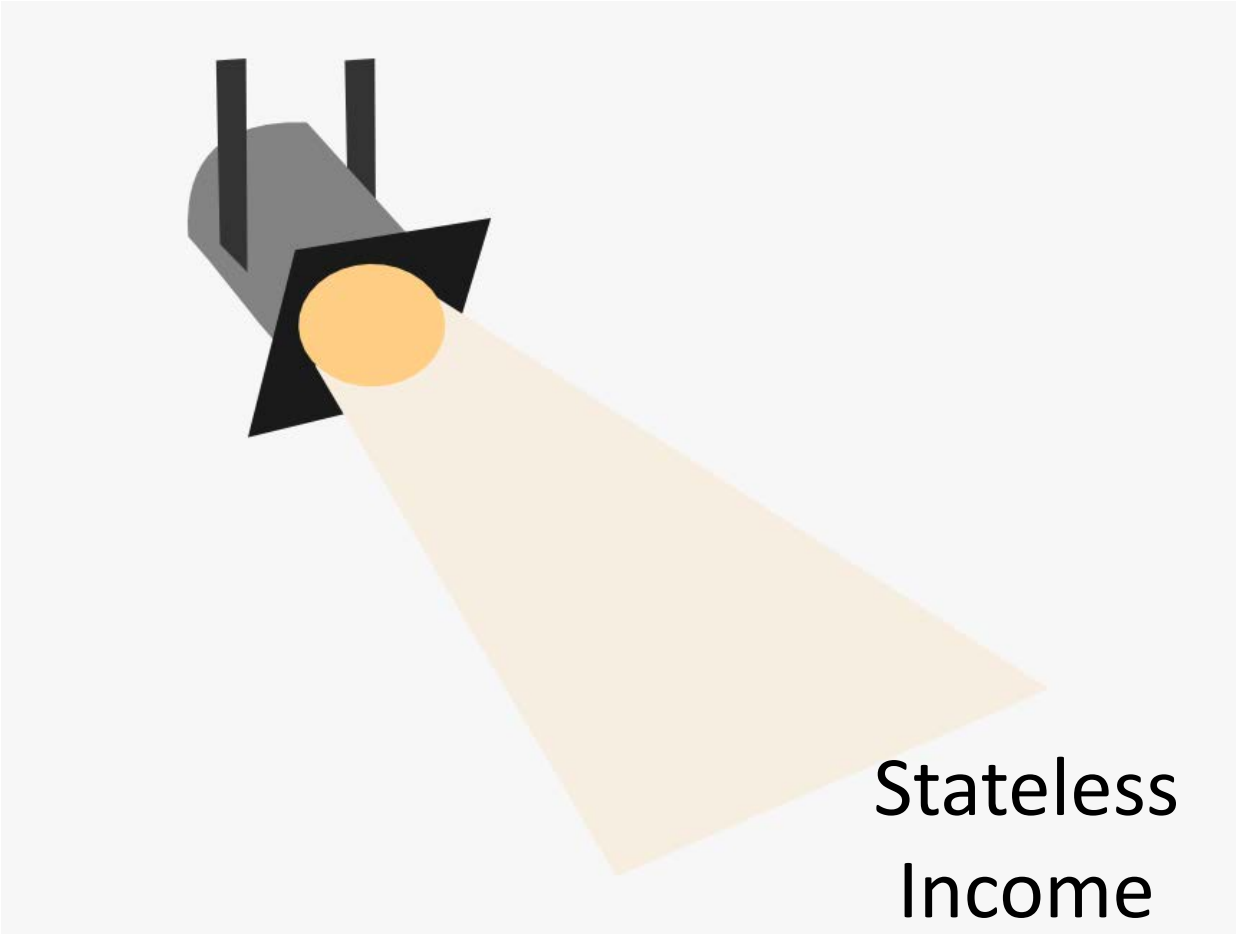
Edward Kleinbard, “Stateless Income”, *Florida Tax Review*, 2011

“The pervasive presence of stateless income tax planning changes everything”

Rosanne Altshuler, Conference in Honor of Edward Kleinbard, 2021

“Edward Kleinbard changed everything”

How did he do it?



What is stateless income?

“income derived by a multinational group from business activities in a country other than the domicile (however defined) of the group‘s ultimate parent company, but which is subject to tax only in a jurisdiction that is neither the source of the factors of production through which the income was derived, nor the domicile of the group‘s parent company.”

What did we know before Stateless Income?

- The role of transfer prices, allocation of debt, and intangibles in income shifting

- Income shifting lowers revenue and has real effects
  - magnifies the attractiveness of investing in low-tax locations
  - weakens the negative impact of a high tax rate on the desirability of a location

- Foreign to foreign income shifting seemed to be a growing problem…
  - Check the box likely responsible for increase in equity income in low-tax countries and decrease in foreign effective tax rates of U.S. MNCs post 1996
  - There was a weakening link between real investment and location of income

Stateless income changes everything

- Destroys any coherence to the concept of “source”
- Privileges MNEs over domestic firms through the prospect of capturing tax rents
- Erodes *domestic* tax base through tax arbitrage
- U.S. MNCs do not suffer a significant competitive disadvantage with foreign MNCs
  - U.S. firms arguably have a competitive *advantage* in stateless income planning over foreign MNCs and domestic firms that are not MNCs

Stateless income changes everything

- Contributes to lock-out effect
  - Results in *lock-in* --- taxpayers can't get hands on the money
  - Leads to domestic borrowing for cash needs exacerbating domestic base erosion
  - The tax distillery was breaking under the weight of foreign "permanently reinvested" earnings waiting to come home
- Introduces massive deadweight losses
- Foreign-to-foreign income shifting **is** a problem for the United States
  - "Domestic base erosion + Tax Rents are the principled answers to question, why should U.S. care about foreign tax minimization?"

Stateless income *turbocharges* attractiveness of investing abroad

Effective Tax Rate Simulations with Stateless Income*

	Before check the box	After check the box
Low tax investment (t=.05)	-.182	-.236
High tax investment (t=.25)	.242	.130

*Assumes U.S. statutory rate of .30. Grubert and Altshuler, *NTJ*, September 2013.

Ed changed everything

- Coined a phrase that changed the world of international taxation
  - Referenced by Finance ministers and Treasury secretaries around the world!
  - Covered by media worldwide
- Heavily influenced legal, economic, and accounting scholarship
- Provided the blueprint for OECD’s BEPS action plan

Last weekend, the OECD presented its first BEPS recommendations to the G20 for an international approach to put an end to so-called "stateless income". Seven "Actions" are being proposed, as part of a 15-point plan.

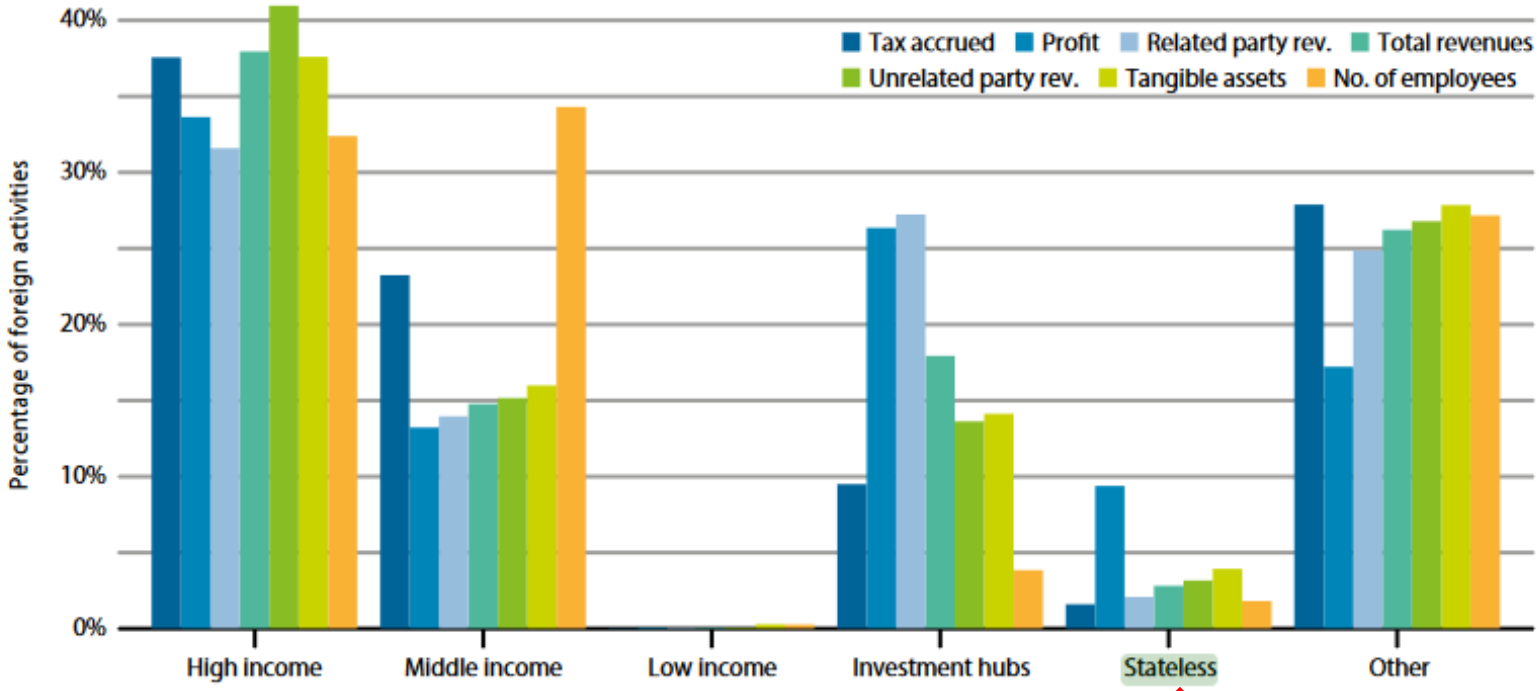
Post by Pascal Saint Amans, Director of the OECD Centre for Tax Policy and Administration and Raffaele Russo, Head of the BEPS Project,

September 29, 2014

How Ed changed everything

- Changed corporate tax statistics (through BEPS CbC reporting)

FIGURE 18: **Jurisdiction groups shares of foreign MNEs activities**



Note: The profit variable could include intracompany dividends in several instances and therefore be upward biased. The bars r[illegible]risdiction groups' shares of different variables (e.g. profit in group x/total profits booked in foreign jurisdictions) across all jurisdictions included in the C[illegible] [illegible]percentages are calculated using Table 1A Panel A (all subgroups). "Other" reflects aggregate geographic groupings.

Source: 2017 Anonymised and Aggregated CbCR statistics

How Ed changed everything

- New IRS reporting form --- Form 8975

Table 1A: Country-by-Country Report (Form 8975): Tax Jurisdiction Information (Schedule A: Part I) by Major Geographic Region and Selected Tax Jurisdiction, Tax Year 2018[1]

Geographic region and selected tax jurisdiction	Number of reporting multinational enterprise groups [2]	Revenues			Profit (loss) before income tax	Income tax paid (on cash basis)
		Unrelated party	Related party	Total		
	(1)	(2a)	(2b)	(2c)	(3)	(4)
All jurisdictions	1,641	16,371,091,002	6,735,372,806	23,106,463,808	2,604,251,545	261,502,681
United States	1,568	11,323,655,145	3,418,412,407	14,742,067,553	1,488,466,473	140,614,147
Stateless entities and other country	**630**	**650,145,629**	**155,503,393**	**805,649,022**	**198,465,612**	**2,356,465**

How Ed changed everything

- Influenced policy proposals at home and abroad
- Provided the most cited academic explanation of the Double Irish Dutch Sandwich (just ask Wikipedia!)

How Stateless Income changed my research

- Thought a principled territorial was better than the current system…
  - "The eradication of stateless income in the field is a highly implausible scenario"
    --- *Throw Territorial from the Train*
- Thought worldwide consolidation was not much better than principled territorial…
  - "… would prove more robust to the corrosive effects of stateless income planning…."
    --- *Lessons of Stateless Income*
- Led to recommendation of per-country minimum tax in Grubert and Altshuler 2013
  - more advantageous than the repeal of check-the-box
  - more effective in discouraging income shifting and raising the effective tax rate in low-tax countries
  - would generate U.S. tax revenue on income sheltered in havens abroad

Effective Tax Rate Simulations with stateless income and 15% minimum tax

(Grubert and Altshuler, *NTJ*, Sept 2013)

	Before check the box	After check the box
Low tax investment (t=.05)		
Current law	-.182	-.236
Per country min tax		.056

Thank you Ed