Destination-Based Cash-Flow Taxation

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May 18, 2017

DBCFT – What is It?

Adopt domestic and international changes

- **Cash flow tax:**
  1. Replace depreciation with immediate expensing
  2. Eliminate net interest deductions (for NFCs)
- **Destination based:**
  3. Ignore foreign activities, as under a <u>territorial</u> tax
  4. But also effectively ignore cross-border activities, by having border adjustments offset business export revenues and import expense deductions

Relation to Other Policies

- **Equivalent to a “subtraction-method” VAT plus a wage deduction (or an equal-rate payroll tax credit)**
  - Border adjustments as under a VAT
- **Equivalent to an “origin-based” cash flow tax plus an export subsidy and import tariff at the same rates**

A Changing Economic Setting

In half century ending in 2014 in US:

- Share of IP in nonresidential assets <u>doubled</u> (BEA, Fed FOF)
- Share of before-tax corporate profits of US resident companies coming from overseas operations <u>quadrupled</u> (BEA)

Implications

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- With multinational activity greater, easier to engage in "inversion"
- Incentive for US firms to do so since other countries (even with high tax rates) don't tax foreign source income

Implications

Increased pressure on systems that tax corporate income in traditional ways, based on where companies produce

- Location of production easier to change because of multinational activity and lower costs of transportation (e.g., chips vs. steel)
- Incentive for firms (US and foreign) to do so because US tax rate is higher

Implications

Increased pressure on systems that tax corporate income in traditional ways, based on where companies report profits

- Profit-shifting easier (via related-party transactions) when have foreign operations and are locating and valuing IP

DBCFT as an Alternative

- Eliminates ability to shift profits out of US, since doing so affects only (and increases) foreign tax liability
- Eliminates incentive to shift production out of US, since zero tax on US-source profits
- Eliminates incentive for corporate inversions, since no distinction in the treatment of US and foreign companies

DBCFT as an Alternative

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Other properties:

- Cash flow tax eliminates tax on intensive margin investment decisions
- Eliminating interest deduction reduces distortion of corporate debt-equity decision
- Much simpler tax system
  - No measurement of income
  - Only domestic transactions
  - No need for complex rules to prevent shifting of income, activities and residence

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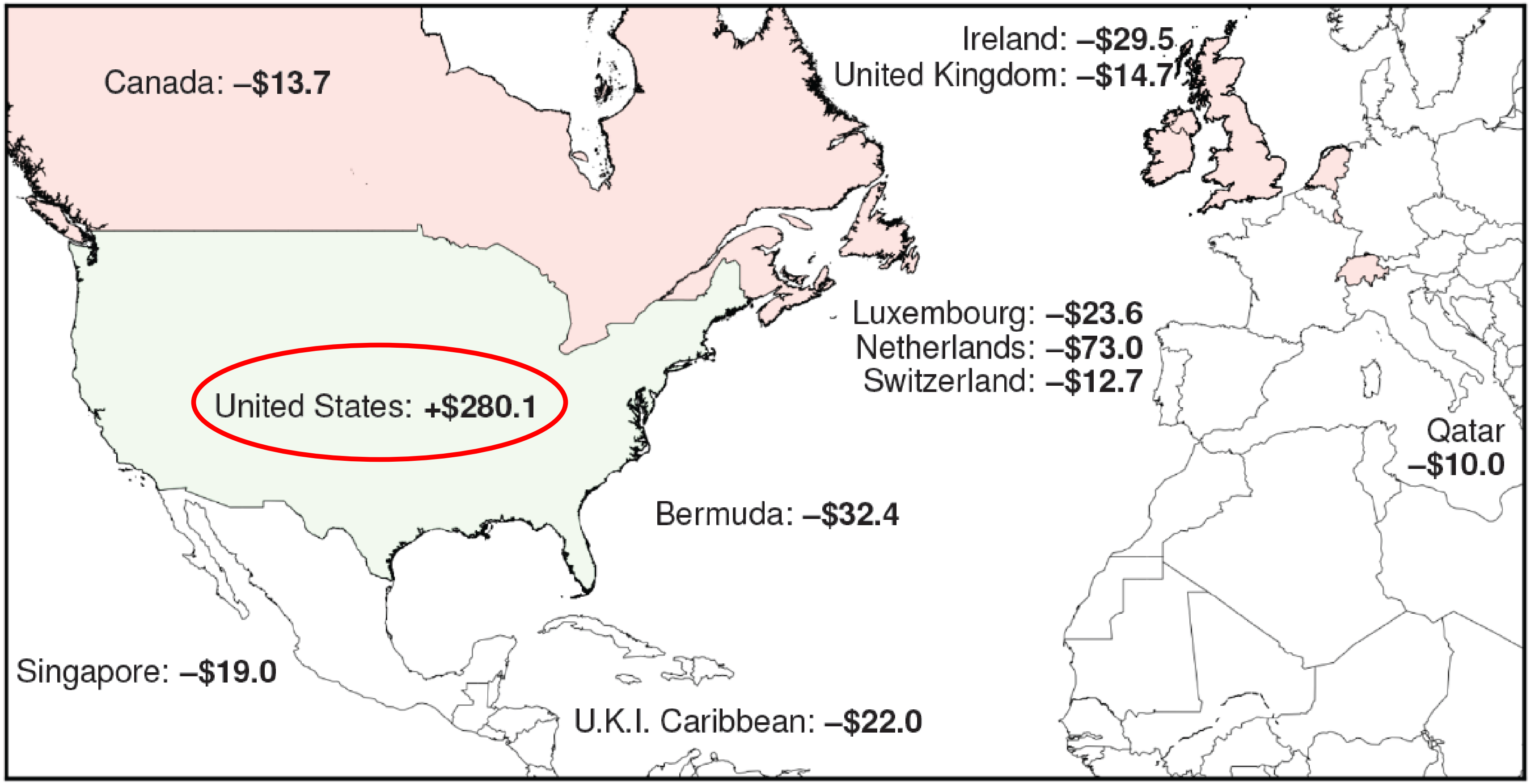
Estimated Profit Shifting, 2012



Source: Guvenen et al., "Offshore Profit Shifting and Domestic Productivity Measurement," NBER, 2017

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- **With full dollar appreciation, business incentives to produce in US don't improve**
- **The DBCFT is regressive**