Tax Foundation University Lecture 3: International Tax Policy
Agenda

• What is international tax policy?
• Approaches to international tax policy
• What did the Tax Cuts and Jobs Act do?
What is international tax policy?

• How countries decide when and how corporations and individuals are taxed within their country
• Example 1: An individual in the United States earns income from consulting services they provided to a business in France.
• Example 2: A U.S. business produces widgets in the United States and sells them to a firm in the United Kingdom.
• Countries typically treat individuals and corporations differently.
Three main approaches to individual taxation

- **Citizenship-based**: All income from all citizens are taxed, regardless of where that income is earned or where citizens live.

- **Residence-based**: All income from all residents are taxed, regardless of where that income is earned.

- **Territorial**: Only income earned within the jurisdiction from all residence is taxed.
Three main approaches to individual taxation

• Example 1: An individual in the United States earns income from consulting services they provided to a business in France.

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<thead>
<tr>
<th>Citizenship</th>
<th>Residence</th>
<th>Territorial</th>
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<tbody>
<tr>
<td>Taxable</td>
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Three main approaches to individual taxation

• Most countries use the residence principle to tax individuals.
• The United States uses citizen-based taxation.
• Very few countries use “territorial” approach to tax individuals.
• Each approach has pros and cons.
Three main approaches to corporate taxation

• Residence-based ("worldwide"): All income from corporations headquartered in a jurisdiction is taxed, regardless of the source of that income. Non-headquartered firms only taxed on profits earned within the jurisdiction.

• Source-based ("territorial"): All income from corporations earned within a jurisdiction is taxed, regardless of where they are headquartered.

• Destination-based: All income from corporations earned from selling in a jurisdiction, regardless of where the goods were produced or where the corporation is headquartered.
Three main approaches to corporate taxation

• Example: U.S. multinational firm makes widgets in the United States and sells them to another firm in the United Kingdom and earns $100 in profits in the United States.

<table>
<thead>
<tr>
<th>Residence</th>
<th>Source</th>
<th>Destination</th>
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<tr>
<td>Taxable</td>
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Three main approaches to corporate taxation

• Corporate taxes classically fall somewhere between residence and source.
  • The vast majority of developed nations are closer to source-based taxation of corporations.

• Countries are starting to consider destination-based taxation.
  • GOP Blueprint: the DBCFT or “border adjustment”
  • EU’s digital tax, advertising taxes
  • Diverted profits taxes
The Tax Cuts and Jobs Act

• The TCJA made significant changes to the U.S.’s international system.
• Previous system: “worldwide” tax system with deferral
• New system: moved towards “territorial” with anti-base erosion provisions
  • Participation exemption
  • GILTI
  • FDII
  • BEAT
• Best understood as a hybrid system: territorial, worldwide, AND destination all mixed together.