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

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

- <u>Residence-based</u>: All income from all residents are taxed, regardless of where that income is earned.

- <u>Territorial</u>: 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.

Citizenship	**Residence**	**Territorial**
Taxable	Taxable	Not Taxable

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.

Residence	Source	Destination
Taxable	Taxable	Not Taxable

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.