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Biden's global corporate tax plans are brave and bold

Proposed global minimum rate could release large economic gains and help reduce popular distrust

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Joe Biden is proving to be both bold in his fiscal ambitions and brave in his choice of battles. This is especially true of the latest effort by the US president and his Treasury secretary Janet Yellen to wade into the labyrinth of corporate taxation. Arcane regulations have long shaped the financial structure of international companies, which exploit legitimate loopholes to save on tax.

So there are substantial benefits to reform, not least helping to fund Biden's multitrillion dollar spending plans. Reform, of course, will require overcoming systemic inertia and entrenched political opposition. So the campaign will also test Biden's ability to mobilise coalitions to drive change.

His plan responds to three different factors. First is the post-pandemic need to raise revenue. Increasing the headline rate of US corporate profit tax to 28 per cent from 21 per cent would raise an estimated $2tn of additional revenue over 15 years. Although not earmarked, this would help pay for the new public infrastructure the US needs. It would also show financial markets there are plans to control the rise in public debt. I find it hard to believe that 28 per cent is excessively high: it only partially rolls back the tax cut from 35 per cent made by the Trump administration in 2017.

As a way of taming deficits, corporate taxes are probably less threatening and more politically acceptable than the recent IMF suggestion of wealth or inheritance taxes. In the UK, chancellor Rishi Sunak also sees corporate taxation as an attractive revenue raiser. In his March Budget, he announced a gradual rise from a 19 per cent corporate tax rate to 25 per cent from 2023. In fact, both countries may now be forming a vanguard to reverse the 20-year trend of lower corporate tax rates globally.

The second force propelling Biden's reform is the opportunity to close international tax loopholes by building on the OECD's unmemorably-named work on "base erosion and profit shifting". Due to tax complexity and the scope for arbitrage, raising taxes in one country often just incentivises companies to shift profits to lower-tax countries, or to havens with zero taxes.

The OECD politely labels such countries, where foreign direct investment is greater than 150 per cent of gross domestic product, as "investment hubs". Some of them are small countries or territories such as Hong Kong and Bermuda. Furthermore, in such hubs so-called "related party" revenues — mostly intra-company transactions — account for a median 40 per cent of their total revenues, according to the OECD. So there will probably be a big impact from Biden's proposal to eliminate US tax deductions claimed by those companies that make payments to related parties in low-tax jurisdictions.

At the same time, Biden's proposal of a global minimum corporate tax rate of 21 per cent seeks to counter a "race to the bottom". It is unlikely to be agreed at that level. It will also be impossible to enforce. Still, setting a global benchmark and monitoring compliance may nudge countries in the right direction.

Finally, the proposal to tax large international companies partly on the share of their sales in host markets would be a major global reform. While long discussed at the OECD, the

Trump administration was unwilling to engage unless it was voluntary for companies. Biden's proposal, which instead asks countries to sign up, would help defuse justifiable public anger at foreign multinationals that have a large presence in host markets but pay little or no taxes there. In Europe, tech companies such as Facebook and Google have faced that criticism and both France and the UK have threatened to impose a unilateral digital services tax. The Biden proposal instead targets large companies across all sectors, which is both easier to administer and fairer, as countries have different strengths in different sectors. Such a sales-based approach to a company's cross-country allocation of its tax bills would be a major change, if agreed. It would help build tax structures that take into account the rapidly digitising global economy.

Together, these three forces present a unique opportunity to reform an outdated, opaque and unfair system of global corporate taxation. There will be opposition from some large companies and many small tax havens. Estimates of the benefits and costs, and the winners and losers, will proliferate. So beware of the numbers that will soon fly in every direction. The sheer complexity of current tax rules will make it hard for even a single company to assess the overall impact. The effect on corporate location and supply chains can only be guessed.

I have served on the audit committees of several international companies and can attest that much unproductive, if essential, time is spent on legal tax planning. Once structures are in place and approved by external auditors, they rarely change. If they do, legal challenges can follow.

Yet few can defend the current system as economically efficient or productivity enhancing. By contrast, Biden's tax reform could release substantial gains by aligning companies' choice of location more closely with underlying supply and demand. As a byproduct, it may also help defuse public distrust of successful global companies. It's a bold plan then, also a brave and global one, with many potential benefits.