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The End of Transfer Pricing

Edward D. Kleinbard
Johnson Professor of Law and Business
USC Gould School of Law
ekleinbard@law.usc.edu

Apple and Stateless Income

- Forget the noise around the EU State Aid case, and focus on the facts:
- On (roughly) \$115 billion of income over 10yrs --
 - Apple Ireland paid Irish tax as low as 0.05% per year
 - That's \$50 per \$1 million of net income
 - Apple Ireland paid tax to the rest of the EU = roughly \$385 million *in aggregate* over 10 yrs (FT 8/31/16)
- 3.2% ETR on Apple's \$91.5 billion PRE
- Apple facts cut legs out from ALP precepts

The Dumb Bunnies Have Been Schooled

- US long-term policy has been revealed by the clumsiness of Treasury's White Paper:
 - Encourage foreign to foreign stateless income gaming
 - On the anticipation of collecting more US tax someday
- But others have tumbled onto this
 - CBC Reporting will keep pressure up
 - Domestic political pushback from Apple facts
- The old order will not withstand the political heat
- BEPS cannot restore dignity to arm's-length standard that is this broken

US Corporate Tax Reform Prospects

- The stars are aligning for corporate tax reform
 - Policy case for reform is clear
 - Differences between rational Members are small
 - Sooner or later lobbyists and Members will have to deliver *something*. So 2017 or bust!
- Basic design has seemed clear to date
 - Statutory rate to 25%, repeal sec. 199 and AMT
 - Territorial tax for outbound FDI
 - Mandatory repatriation tax on PRE
- Territorial tax *requires* anti-abuse rule
 - Minimum tax is ugly but effective responsive to base erosion

New Regimes Will Vitate Transfer Pricing

- US statutory rates will fall in tax reform
- But for US based international firms, ETRs are heading **up** not down
 - How could they go lower?
 - US: CBC minimum tax? Is that sufficient any more?
 - Rest of World: More tax, now
 - BEPS + CBC reporting; UK Google tax
 - EU State Aid inquiries = compelling narratives
 - Large revenue shortfalls in many countries
 - General revulsion at stateless income gaming
- What country will rely on ALP after Apple facts?

Response I: True Worldwide Consolidation

- Apple and Pfizer point the way!
 - Successful stateless income cash tax gamers
 - BUT, they report to investors that they operate in a 25% global tax rate environment
 - *This is the window through which stakeholders view them*
- *So why not give them the world they claim to inhabit?*
 - WW tax consolidation – just like financial reporting
 - 25 percent US tax rate on WW income, with FTCs
 - Just like territorial w/ a minimum tax, where minimum tax is same as domestic rate 😊
- Transfer pricing games vitiated if US rate is in middle of pack and income cannot be taxed at lower rate

II: Destination Based Cash Flow Tax

- DBCF by design eliminates payoffs to transfer pricing
 - Because it is a consumption tax not an income tax
- Like a VAT w/deduction for domestic labor inputs
 - Deduction for exports, no deduction for imports
 - But also deduction for domestic labor inputs
 - So corporate tax base = domestic consumption attributable to:
 - (i) all “rents” (supersized returns on capital) +
 - (ii) foreign labor inputs
- Almost certainly violates WTO
 - Beggar thy neighbor tax on foreign labor?
 - Exchange rates cannot adjust to neutralize when labor inputs vary

Even the Dinosaurs Gave Way

- Dinosaurs were a highly successful animal branch
 - But cataclysmic events forced even them to extinction
- Apple is such a cataclysmic event for transfer pricing
 - TP cannot evolve quickly enough to respond
- CBC minimum tax, true WW consolidation, DBCF tax
 - All are aimed at vitiating relevance of transfer pricing
- WW Consolidation the best of the bunch
 - Still an income tax, and retains a residual tax on global exploitation of US-developed IP
 - Not a beggar thy neighbor tax
 - Straightforward to implement