

# Keeping Our Cool: The Environmental Impact of International Tax Reform

Roberta F. Mann

Mr. & Mrs. L.L. Professor of Business Law

University of Oregon School of Law

GCET 2014

# Presentation Outline

- Environmental consequences of the global economy
  - Focus on GHG emissions
- What would effective environmental tax reform look like?
  - Considering a U.S. carbon tax
- Environmental consequences of income inequality
  - Focus on GHG emissions
- Goals of U.S. international tax reform
- Why U.S. international tax reform is on the agenda
- How can the U.S. international tax system be reformed to reduce environmental consequences?
  - Limitations on unilateral action
  - Focus on income inequality

# Environmental Impacts of Global Markets

- Can or should globalization be stopped?
  - The locavore’s dilemma
- “Race to the bottom”
  - Tax
  - Environment
- Supply chain
  - “Roughly half of the GHG emissions in the United States can be linked to the supply chains of consumer products.”
- Transportation
- Sustainability assessments



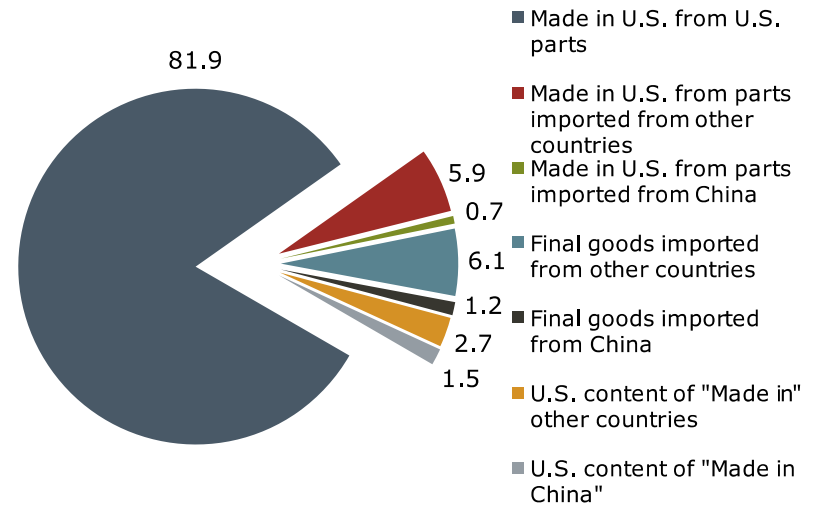
# Import content of US personal consumption expenditures

**Figure 1**  
**Import content of U.S. PCE, 2000–2010**



Sources: Bureau of Economic Analysis, Bureau of Labor Statistics, Census Bureau, and authors' calculations.

**Figure 2**  
**Geography of U.S. PCE, 2010**



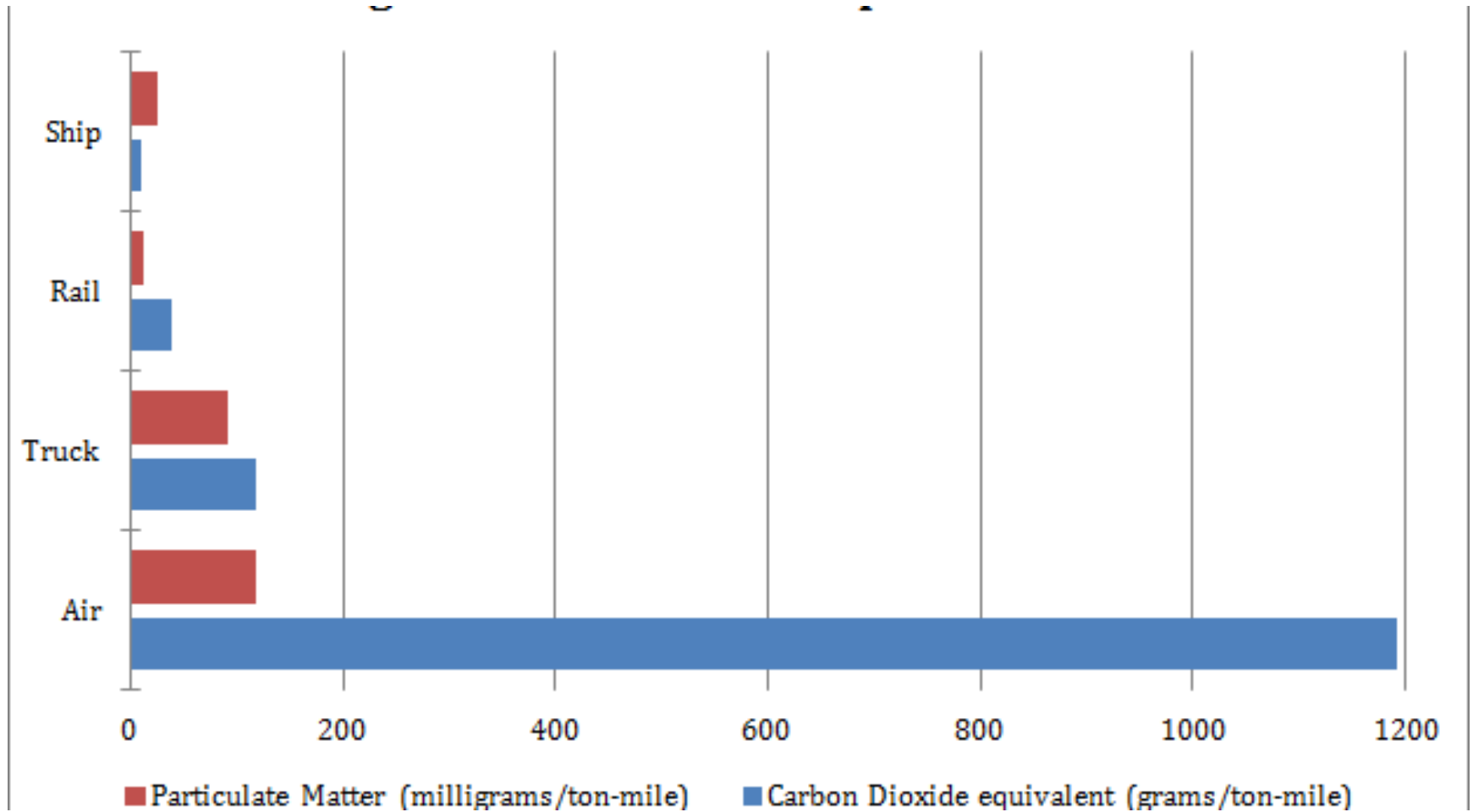
Sources: Bureau of Economic Analysis, Bureau of Labor Statistics, Census Bureau, and authors' calculations.

# The locavore's dilemma

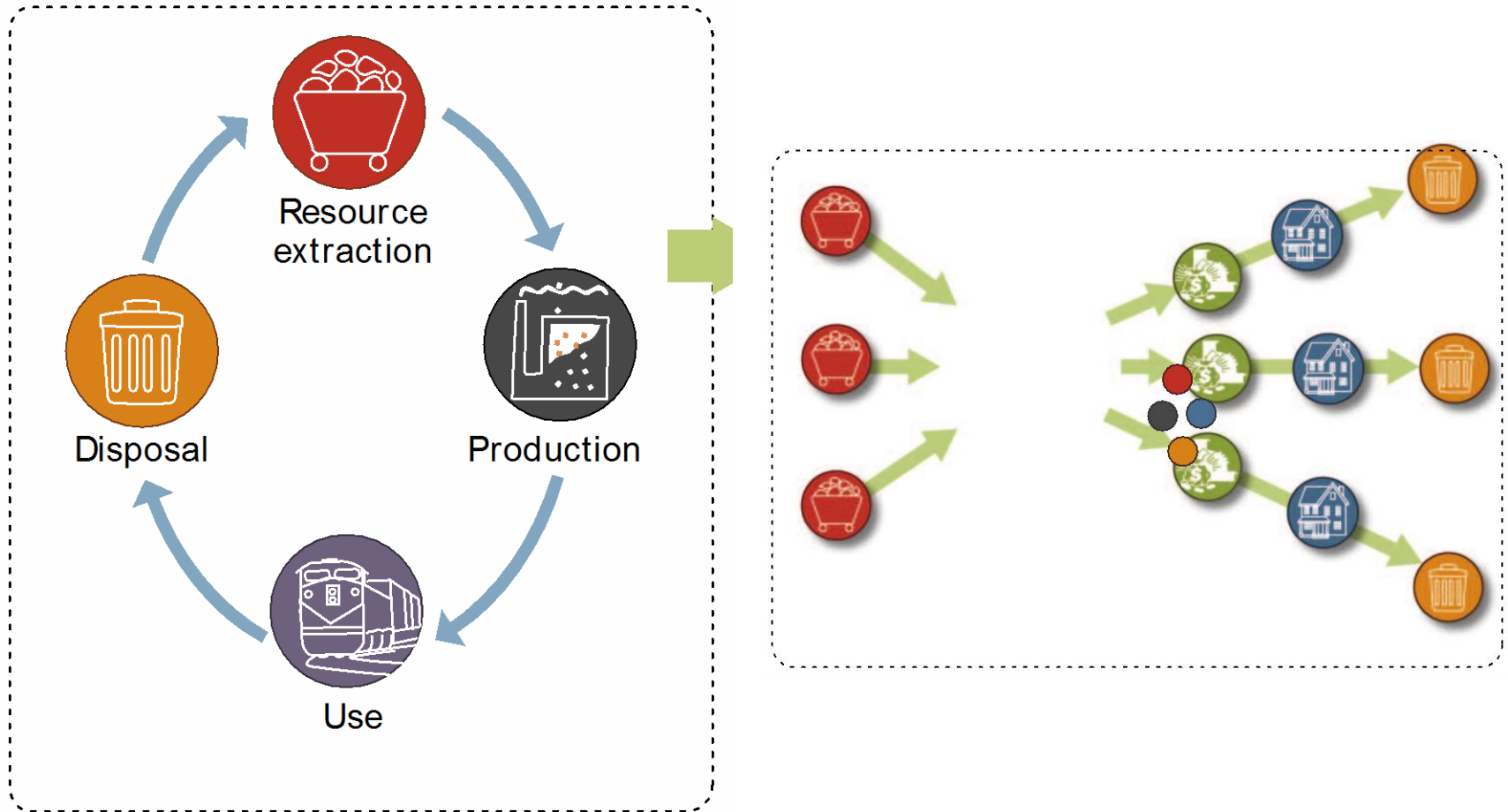
**Figure 3**  
**US Map Showing the Approximate GHG Breakeven Point between**  
**Bordeaux and Napa wines**



# Transportation



# Life cycle analysis



# What would effective environmental tax reform look like?

## Domestic taxation

- Repealing oil and gas tax incentives
- Improving renewable energy tax incentives
- Amending broad-based tax incentives like the home mortgage interest deduction and the exclusion for transportation fringe benefits

## Why not effective

- Global pricing for oil, so only affects domestic market share, not price
- Inefficient (high cost per GHG reduction)
- Economic analysis cannot determine the GHG effect, difficult to differentiate from overall effect on the economy



# Goals of U.S. International Tax Reform

- What is the normative goal for US international tax reform?
  - Stop revenue loss
  - Protect U.S. jobs
  - Strengthen U.S. economy by improving competitiveness of U.S. MNCs
- What would be the best US international tax system for the global environment?
  - “Pure” territorial
  - Stronger worldwide
  - Current system with modifications

# Would a U.S. carbon tax be effective?

- Competitiveness
  - Sizable foreign competition faced by agricultural, mining, and manufacturing sectors
  - Those sectors constitute 28% of CO2 emissions
  - If \$15 per ton CO2 tax, 1 percent of U.S. production would shift overseas
- Significant domestic political opposition
- International trade law
  - Border tax adjustments probably would pass muster
  - Subsidies contingent on using U.S. goods probably would not
  - Stiglitz: U.S. failure to impose carbon pricing might be a subsidy under GATT
  - Four existing WTO challenges to renewable energy subsidies, but none to fossil fuel subsidies (?)

# Limits on ability of U.S. to take unilateral action on international tax

## Tax treaties

- Art. 23, ¶ 2 U.S. Model Treaty – Foreign Tax Credit
  - Relief from double taxation: The U.S. agrees to allow to its citizens and residents a credit against U.S. tax for income taxes paid or accrued to the other Contracting State
- Art. 7, ¶ 2 – Arm's length transfer pricing
  - There shall be attributed to the permanent establishment in a Contracting State the profits that it might be expected to make if it were a distinct and separate enterprise engaged in the same or similar activities under the same or similar conditions

## GATT & WTO

- Art. III Principle of non-discrimination
  - Domestic subsidies prohibited
  - Exception for provisions to protect human or animal health or life

# Why is Int'l Tax Reform on the Agenda? Corporate Inversions on the Rise

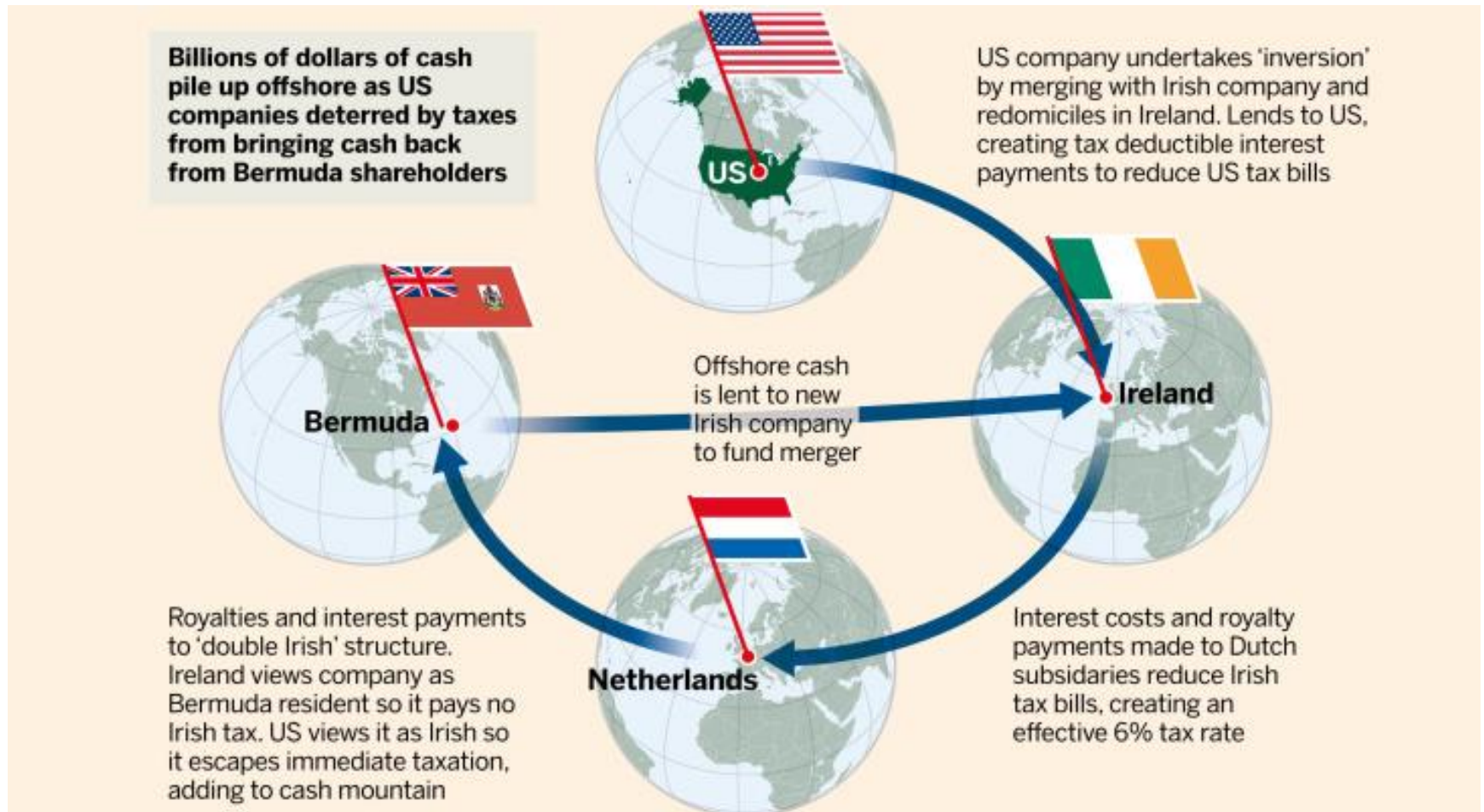


# Why Invert?

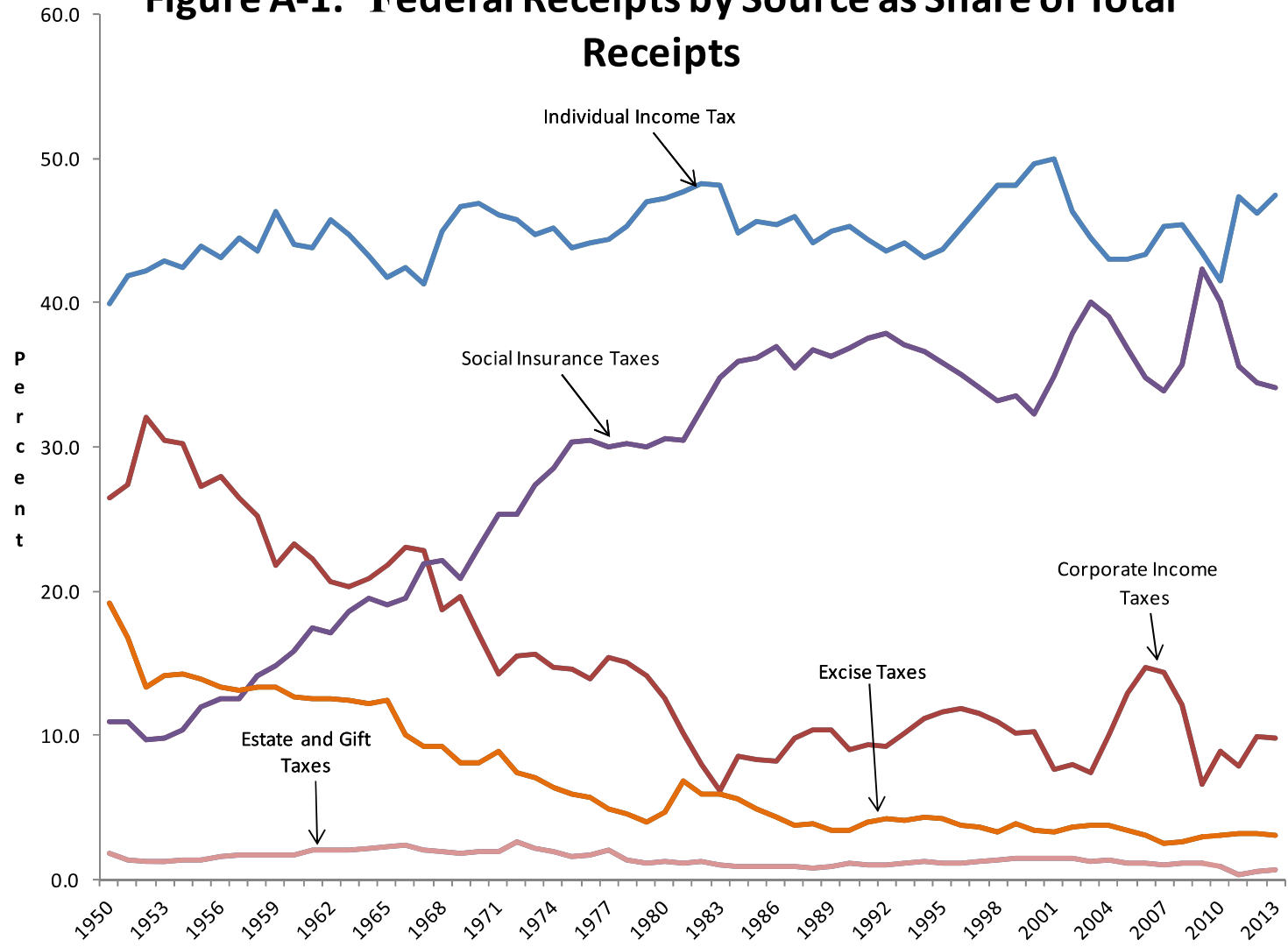




# How Inversions work



# Figure A-1.—Federal Receipts by Source as Share of Total Receipts



Source: Office of Management and Budget; Historical Tables, Budget of the U.S. Government, Fiscal Year 2015, and Joint Committee on Taxation Calculations

# Why is Int'l Tax Reform on the Agenda?

Percentage

30

25

20.7

17.6

15.3

17.5

13.8

13.0

17.0

13.1

12.6

21.0

0

2008

2009

2010

n/a

n/a

n/a

n/a

n/a

n/a

n/a

12.6%

Profitable Schedule M-3 filers

## Definition of Effective Tax Rate

- Total book tax over book income
- Current book tax over book income
- Actual tax paid over book income
- Actual tax paid over taxable income



# Two approaches to environmentally sound international tax reform

## **Broad**

- Reduce income inequality
- Environmental Kutznets curve
- Income inequality in the U.S. over time
- Incidence of corporate taxation in the U.S.
- Considering corporate integration

## **Narrow**

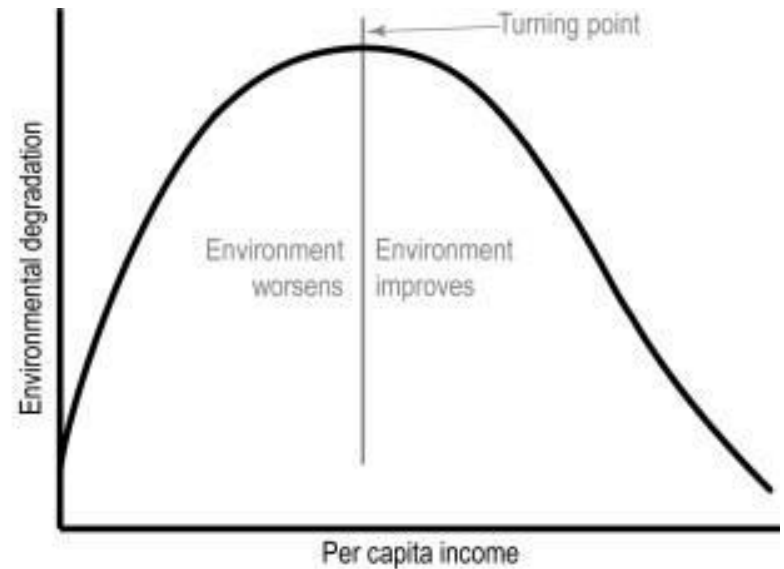
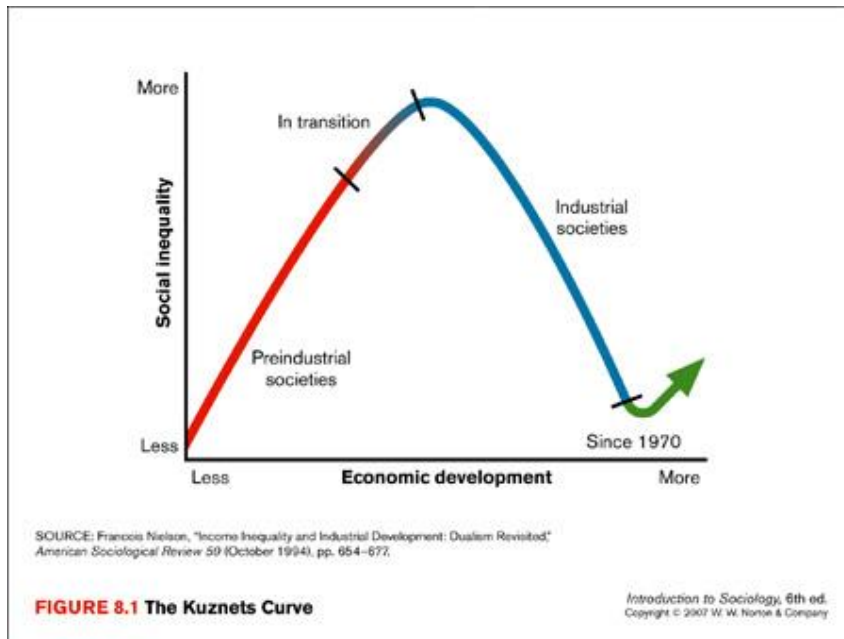
- Strengthen manufacturing exception to subpart F rules
- Limit foreign tax credit to taxes paid to countries with robust carbon pricing or meeting certain sustainability criteria
- Strengthen income sourcing rules and include a green component in transfer pricing

# Joseph Stiglitz wrote:

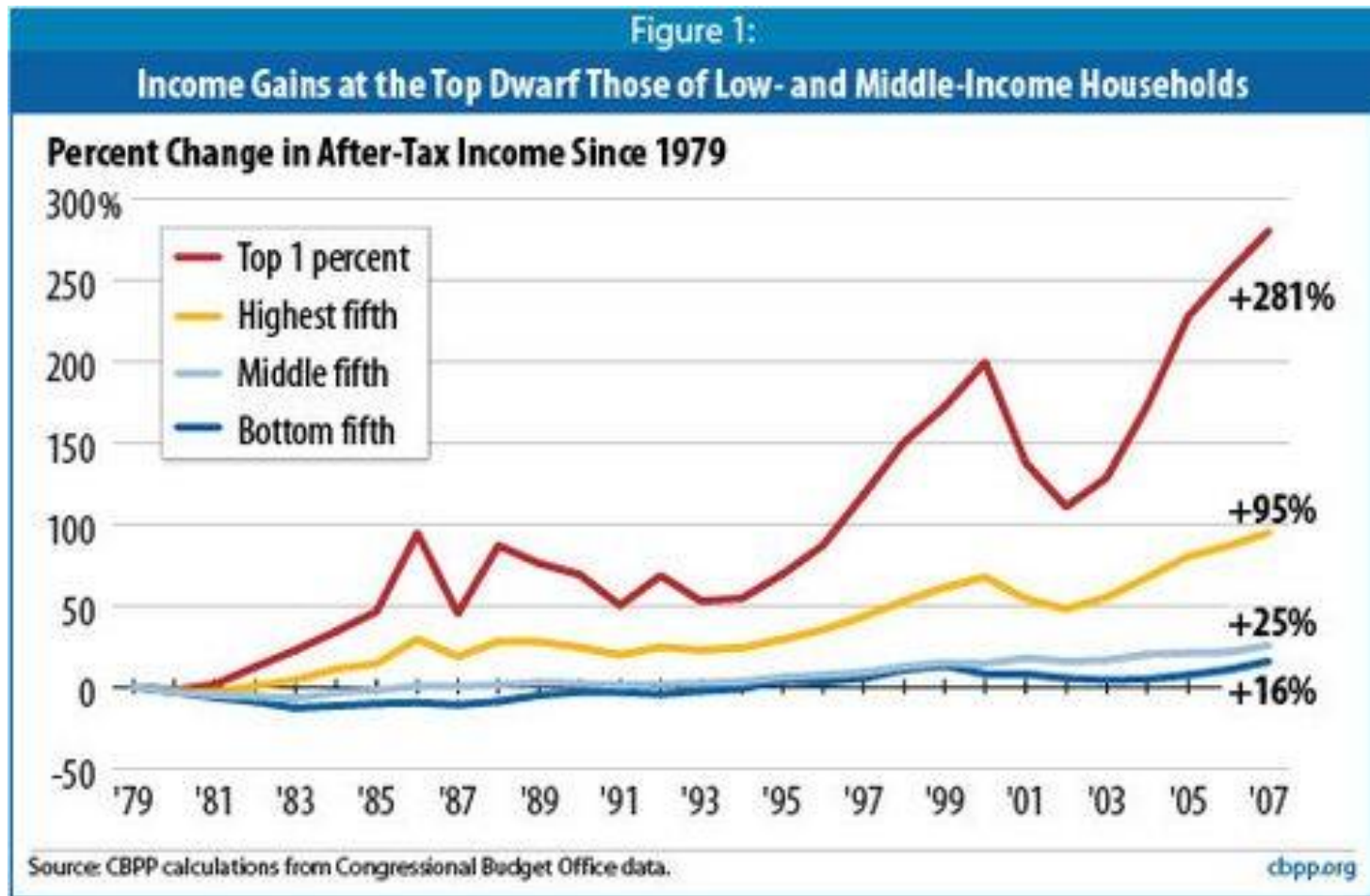
- *[I]n democracies, the desperately poor tend to have less of an interest in pursuing policies designed to protect the environment, because their most important concern is doing whatever's necessary to get out of the current situation. So societies with more inequality will get less support for good environmental policies.*



# Broad approach to reform



# Income Inequality in the United States



# Sustainable Competitiveness

## World Economic Forum Global Competitiveness Report 2013-14

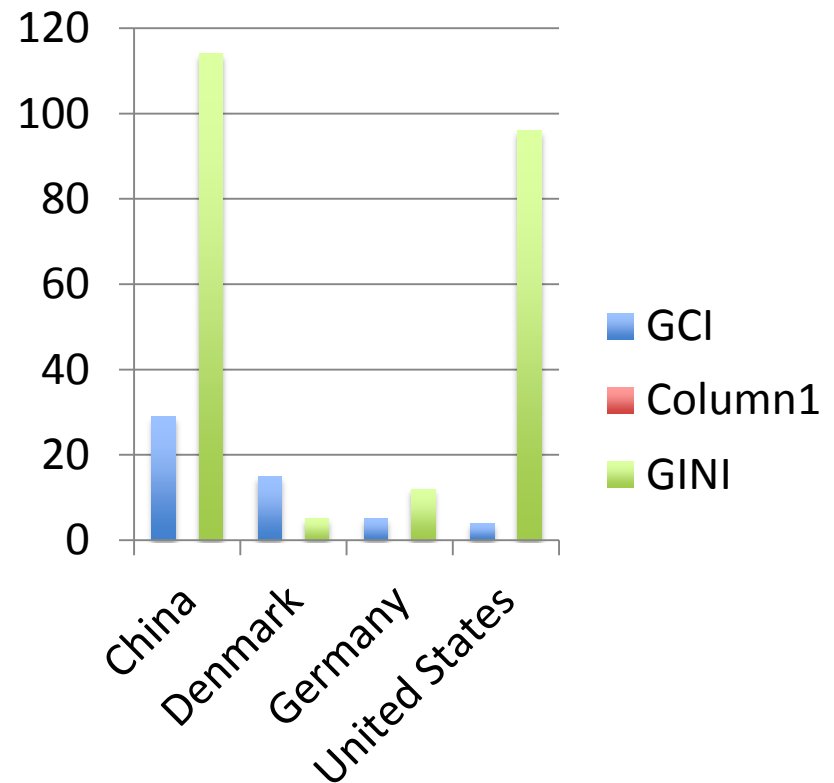
Country	Rank	Environmental Commentary
Germany	4	Stringent and well-enforced regulations and the existence of a large amount of protected land indicate Germany's particular attention to environmental issues.
United States	5	The country shows limited political will to firmly improve on critical environmental issues, such as high pressure on water resources and the need to protect habitats from urbanization.
China	29	The level of emissions (both carbon dioxide and particulates) continues to rise, and air pollution is worsening in several cities. Rapid industrialization has taken a heavy toll on the Chinese natural environment, <i>which has also resulted in productivity loss, with the total cost arising from pollution estimated at 3.1 percent of GDP.</i>

# Sustainability and Income Inequality

## WEF factors

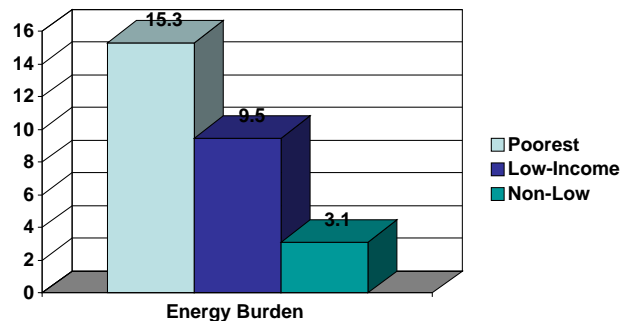
- Environmental policy
- Use of renewable resources
- Degradation of the environment
  - CO<sup>2</sup> intensity

## WEF ranking vs. GINI Ranking



# Distributional effect of carbon tax

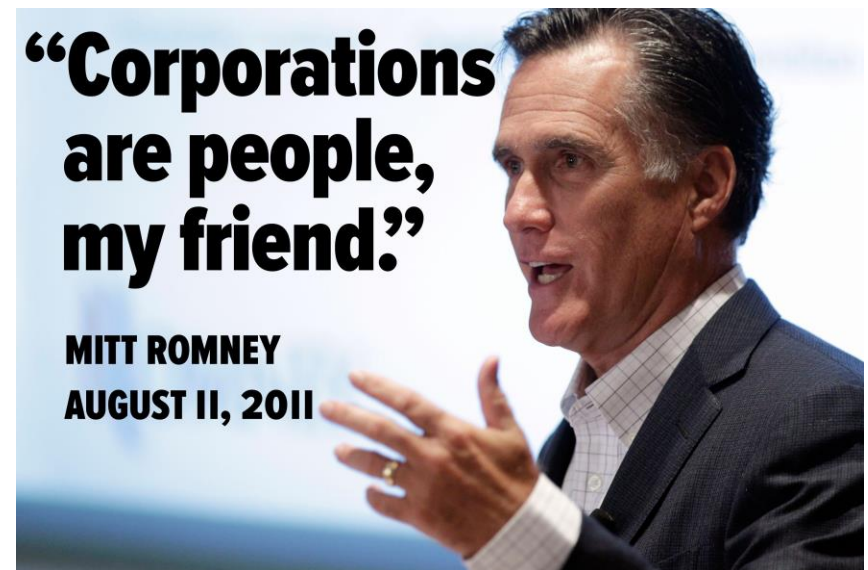
Lower-Income Households Pay a Larger Share of Income on Residential Energy and Transportation



- Uses of Revenues
  - Energy tax credits for low/middle income households
  - New energy component to EITC
  - Reducing payroll taxes
  - Per capita dividend\*

# International Tax Reform is Corporate Tax Reform

- Who bears the burden of the corporate tax?
  - Capital?
  - Labor?
- Does a lower corporate tax burden result in less progressive tax system (and therefore more inequality)?



But not for tax purposes – corporate residency is based on state of incorporation



# Conclusion

- Environmental protection is a valuable perspective for tax reform
- Caution should be exercised in strengthening corporate residency requirements, so that the tax race to the bottom does not coincide with the environmental race to the bottom
- Future research: Impact of tax reform on manufacturing location decisions

# Narrow approach to reform

## Residency

- Corporate residence does not relate to physical location
- Residency on paper doesn't change GHG emissions
- Corporate inversions don't change emissions

## Subpart F proposal

- Backstop to deferral
- Certain types of income of foreign subsidiaries of U.S. companies currently taxed in U.S.
- If “substantial transformation” occurs in foreign country, then deferral allowed
- *Limit exception to activities in countries with robust carbon pricing or meeting sustainability criteria*

# Narrow approach to reform (2)

## Source

- Under U.S. law, source of income can easily be shifted
- Source does not relate to physical location – “stateless income” problem
- First, need to tie source to physical location to affect GHG emissions

## Proposals

- Foreign tax credit
  - Restrict availability of FTC based on environmental performance of source country
- Transfer pricing
  - Green formulary apportionment
- Both proposals raise treaty concerns