Funding the Future

The chance to review international tax architecture see...

Published: January 13, 2026, 4:05 pm

The IMF's Fiscal Monitor report published last week entitled Taxing Times has to be quoted at length when it comes to the reform of the international tax system:

One set of gaps that has received particular attention in the aftermath of the crisis–reinforced, as was the case with financial sector taxation earlier in the crisis, by a strong public sense of injustice39–are those in the international tax framework. There are broadly two sets of issues. One–discussed in the next subsection–is (illegal) evasion by individuals. The other is avoidance by multinationals–legal (or, cynics might say, not obviously illegal).

Google, Starbucks, and other household names have famously managed to pay very little corporate tax. But of course, they are far from alone in this. Importantly, the issue is not just one for advanced economies: indeed, it is likely an even greater concern for developing countries, typically more reliant on corporate tax receipts. Nor is the issue new: U.S. President John F. Kennedy argued for fundamental reform 50 years ago. What is new is the attention.

Some of the strategies that multinationals use to reduce their tax liabilities–by base erosion and profit shifting, in the current jargon [can become] mind-bogglingly complex..... All this is symptomatic of an international tax order under stress–unsurprisingly, since it was built piecemeal on the basis of principles that have become increasingly outdated (as a result, among other things, of the increased importance of intrafirm trade, of services that can be delivered remotely, of the easing of capital movements, and of massively increased financial sophistication).

Assessing how much revenue is at stake is hard. For the United States (where the issue has been most closely studied), an upper estimate of the loss from tax planning by multinationals is about US$60 billion each year–about one-quarter of all revenue from the corporate income tax . In some cases, the revenue at stake is very substantial: IMF technical assistance has come across cases in developing countries in which revenue lost through such devices is about 20 percent of all tax revenue.

With strong support from the Group of Eight (G8) and Group of Twenty (G20), the Organisation for Economic Co-operation and Development (OECD) has developed a two-year action plan to address key aspects of base erosion and profit shifting. This is an important exercise–and a difficult one, both technically and politically.

The fundamental difficulty in this area is the lack of cooperation in setting tax policies–tax competition, in a broad sense. Many of the devices facilitating base erosion and profit shifting are not unintended loopholes; they are there to secure national advantage. (Examples would be invidious, since so many countries have something on offer.) The spillovers that arise from noncooperative tax setting mean that the gains to one country come at the expense of others–and the sum of the losses likely exceeds the gains.

Tax competition and spillover issues go far beyond the devices that are the focus of base erosion and profit shifting. A number of advanced economies, for instance, have moved or have been urged to move away from a "residence-based" system for taxing active business income, under which they tax such income arising abroad but give a credit for foreign taxes paid, to a "territorial" one, under which they simply exempt such income from tax in the home country. Such a shift can have significant implications for host countries, since any tax they charge will now remain as a final burden for the investor rather than be offset by reduced taxation in the investor's home country. As a result, these countries, anxious to attract investment, may face greater pressure to offer tax incentives, lower tax rates, and take other measures that erode their revenue bases. Likewise, even if countries have doubts about the effectiveness of tax incentives in attracting foreign direct investment–the evidence is that other factors are much more important41–they will hesitate Klemm and van Parys (2 find that tax measures have attracted foreign direct investment in lower-income countries, and to eliminate them unless their neighbors do the same. In the event, closing off just some loopholes may make competition through other means more intense.

Tax competition can simply result in tax rates' ending up too low. In the limit, all countries could be left with perfectly aligned tax rates and territorial baseand no compliance problems. There would then be norevenue loss from base erosion or profit shifting and nodistortion of real decisions–but there would still bea social loss suffered, since effective tax rates would bebelow the levels to which a collective decision would have led.

Achieving meaningful cooperation in identifyingways in which to beneficially constrain tax competition will not be easy, to put it mildly. Nationalself-interest, of course, always looms very large. Butdeep technical issues need to be faced head on. Forinstance, a system in which countries can differentiate in their tax treatment between highly mobile and immobile activities–perhaps not far from the currentsituation–can lead to less-damaging outcomes thanone in which they must treat all investments equally. And formula apportionment of a multinational's taxable profits across jurisdictions can *lead to more aggressive tax competition than the current arm’s length principle. But the gains from closer cooperation may be considerable–strengthened corporatetaxation, especially as it bears on rents, could be amuch-needed efficient source of additional revenue.*

The chance to review international tax architecture seems to come about once a century; the fundamental issues should not be ducked.

My emphasis added.

But so true.

And it's also true that there is likely to be no one technical solution. But the first acknowledgement is that we don't even have an adequate way of recording corporate income for tax as yet.

And that has to, in my view, be the start point for this journey.