

The Destination Based Cash Flow Tax is a terrible idea

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Nick Shaxson [has a post on the Tax Justice Network blog](#) explaining why the destination based cash flow tax (DBCFT) is a terrible idea as a replacement for corporation tax. I am pleased that he has: this idea is truly terrible. As Nick notes:

As the IMF's Christine Lagarde [remarked on March 10](#), "we need a fundamental rethink on international taxation."

Some of us have been saying that for a long time. But DBCFT is nit the answer, nick provides considerable evidence on his blog. I recommend reading it in full. And I stress, Nick is fair: he tries to find merit where he can. Here, though, I pick out just one of the ten flaws Nick identifies:

The CIT serves many key purposes, beyond just raising revenue, so abolishing it would do away with many of its key functions. The most important, perhaps, is the CIT's role in serving as a backstop to the personal income tax system. That's because if you cut corporate tax rates too far, rich folk will arrange to convert their ordinary income into corporate forms, paid into shell companies, in order to pay the lower corporate rate instead of the ordinary income tax. This cannibalises the income tax system, and the revenue losses are potentially enormous. (This is one of the main reasons why most countries set up the CIT system in the first place.) The DBCFT removes this prop to the income tax system. That's because it's a sales-based tax, and these personal shell companies aren't generally in the business of making sales: they are set up to accrue (and defer) income and capital gains.

In a related matter, the corporate income tax also penetrates many [trusts and other fortress-like vehicles for holding unaccountable wealth: even if the beneficial owners of such vehicles may be able to escape paying tax on their income, the underlying corporate holdings generally do pay CIT. So it serves many other vital purposes, and its abolition would generate a wide range of harms \(as we noted in our document \[Ten Reasons to Defend the Corporate Income Tax.\]\(#\)\)](#)

There is no defence possible from the DBCFT promoters in this issue. It simply fails at

this level. Just as it fails to provide any effective basis for taxing investment income and capital gains in companies. Any government seeking a level of tax revenue to manage its fiscal budget will then, if DBCFT was in use, have to shift taxes onto individuals and consumption in that case because DBCFT effectively exempts the wealthy and capital from much of the (already little) tax that they might owe at present.

Do the proponents of this tax really not realise this? If not, why not?

And if they do, why are they still proposing it? That is a question that they have to answer.

In the meantime, DBCFT is a disaster, and as Nick says, there is a better alternative:

The better alternative, as we've mentioned - the only reasonable alternative, we believe - is some version of Unitary Tax with Formula Apportionment. We've just made [a submission to the OECD](#) on this basis.

With such a system, you take a multinational's total global profits. Then you apportion or allocate those profits between countries according to a formula, which may be based on (for example) how large its sales are in each country, and also how large its workforce is in each place. Then that country can tax their allocated portion of global profits at whatever rate you like.

This is also the approach favoured [by ICRICT](#), and it is also examined favourably in another [new IMF paper](#). Curiously, the leading academic proponent of the DBCFT, Mike Devereux, co-authored [an article](#) in favour of this system in 2009. It's not clear why he changed his mind, given that he had previously proposed the DBCFT in 2002.

This system would of course have its own difficulties and complexities, but it is without doubt the most rational and internally coherent system, and the way forward for tax justice.

Now, with the international tax system starting to come apart at the seams, it's time to push for the right approach.

And the Destination Based Cash Flow Tax isn't it.

I agree with Nick.