Comment: How Should Multinationals Be Taxed?

By Theo Vermaelen, INSEAD Professor of Finance

The recent attack on the tax policies of corporations becomes close to ridiculous when politicians argue that companies that try to avoid taxes (legally) are “socially irresponsible” and “immoral."

The people interviewed in the recent INSEAD Knowledge piece ***How Should Multinationals Be Taxed*** are disproportionally representatives of the political left: two socialist politicians (Fleur Pellerin from France and Dirk van der Maelen from Belgium) and representatives of left-wing organisations (War on Want, Tax Justice Network). As usual, the Left talks about taxation in terms of “fairness” and “justice” rather than economic efficiency. In other words, it’s always about dividing the pie more equally assuming that the size of the pie is unaffected. Fairness and justice are very subjective concepts. The French Left believes that taxing people at 75 percent when they make more than 1 million euros is “fair”, while I believe that this is an unfair confiscation of private property by the State.

The debate about fairness also ignores the fact that corporate income is taxed twice: once at the corporate level and then again at the personal level when investors pay taxes on capital gains and dividends. Since 2,000 U.S.

taxpayers have paid more than $US1 trillion in capital gains taxes. So the capitalists have shared their gains with the rest of us. Presumably a significant part of this tax payment comes from Apple and Google shareholders, considering the meteoritic rise in their stock price during the last 10 years. So it is not true that the shareholders of Google and Apple don't pay taxes on the profits generated by their companies.

A question of morality

The recent attack on the tax policies of corporations becomes close to ridiculous when politicians argue that companies that try to avoid taxes (legally) are "socially irresponsible" and "immoral"**[1]**.   Such a statement makes one immediately think of the famous quote from Judge Learned Hand **[2]**

"Anyone may arrange his affairs so that his taxes are as low as possible; he is not bound to choose that pattern which best pays the treasury. There is not even a patriotic duty to increase one's taxes. Over and over again the Courts have said that there is nothing sinister in so arranging affairs as to keep taxes as low as possible. Everyone does it, rich and poor alike and all do right, for nobody owes any public duty to pay more than the law demands"

In other words, the CEO, has a fiduciary responsibility to minimise corporate taxes. If he wants to do good by financing the Belgian and French social model, he should do it not with shareholders money but with his own money (for example by voluntarily taking fewer deductions than legally permissible when filling out his personal tax form). Paying more taxes than is legally required may also mean breaking the implicit contract with shareholders if they expect the CEO to do everything legally possible to minimise corporate taxes. In my view, breaking these implicit contracts is unethical.

Employment opportunities

Belgium and France are two countries governed by Socialist leaders and both have the highest unemployment in history. It seems that increasing taxes on corporations, and thereby discouraging investment and employment, should be the last thing politicians should be thinking about. They should be supportive of the fact that companies can separate the location where they pay taxes from the location of their operations. If Google was subject to French taxes it would do less business in France and French unemployment would be even higher than today.   So the slogan on the web page of the Tax Justice Network “Tax havens create poverty” is far too simplistic.

The action plan of the OECD to fight the “beggar-my–neighbour” tax policies to create a “level playing field” is similar to the behaviour of a cartel that wants to prevent price competition. Competition between governments keeps taxes low and forces politicians to stop their wasteful spending. It increases return on investment and stimulates private sector growth, rather than growth of non-value creating activities in the public sector. It seems to me that this is the true reason for the tax offensive: after a few virtuous austerity years, politicians want to go back to their traditional “tax and spend” addiction, which does not bode well for the economic future of the so-called “developed” world.

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[1] EU tax commissioner Algirdas Semeta is quoted by the BBC on May 22 2013 that “a corporation cannot be treated as socially responsible if it aggressively plans its tax obligations” and such behaviour is “not morally right”.

[2] Judge Learned Hand (1872-1961), Judge U.S. Court of Appeals made this famous quote in the case of Gregory v Helvering (1934)

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