



# The Future of Corporate Income Taxation

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## Abstract

This article examines the future of corporate income taxation amid globalization, digitalization, and the rise of artificial intelligence. It highlights the challenges of profit shifting, tax competition, and domestic distortions, which jointly push the system in the direction of a neutral destination-based cash-flow tax. Such a tax could be complemented by a personal tax on either all capital income or the normal return to capital. This combined system has the potential to enhance equity and revenue, while addressing current inefficiencies. International cooperation would smooth the transition toward such a system, yet even in its absence global forces can drive tax systems in this direction

*Keywords:* Corporate income tax, Tax reform, Destination-based cash flow tax.

*JEL Classification:* H25.

## Introduction

The future of corporate income tax (CIT) has long been subject of debate, marked by recurring predictions of its decline and fundamental transformation. In 1999, for instance, Michael Devereux said: “*If I can make a bold prediction, I would say that corporate taxes will eventually just wither –there will be no corporate tax at all, partly because of the process of competition between states and partly as companies can organize their affairs effectively to reduce their corporation tax*” (House of Lords, 1999).

Today, 26 years later, the CIT remains under strain –with rates having fallen from around 30 to slightly above 20 percent. Also, there is widespread proliferation of tax incentives and

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profit shifting continues to challenge revenue mobilization, especially in countries with high tax rates or limited capacity. On average, the CIT still raises approximately 3 percent of GDP in revenue, similar to what it was three decades ago. This is, however, not entirely reassuring, because lower CIT rates likely induced more personal income to be shifted into the corporate sector by changing the legal forms. More generally, with the profit share of GDP rising in many countries, revenue should have even increased rather than stabilized. At least in part, international coordination efforts aimed at reducing profit shifting may also have contributed to protecting the CIT revenue. Yet, cracks in that system remain visible and the question is how it will evolve in the coming decades. That is: what is the future of the corporate income tax?

Discussions of corporate income taxation often get absorbed in technicalities, such as design and implementation of the globally agreed minimum tax rules or how to interpret international guidance on international tax matters. This paper is not about such details. Instead, our focus is on the big picture: what principles will guide the international tax framework of the future? What will the design of the CIT system look like? In exploring these questions, we focus on the long run, thus ignoring developments that might happen over the next few years. Aside from taxation at the corporate level, moreover, the paper offers some reflections on the future taxation of capital income at the individual level to which the CIT is inherently linked.

The paper starts with a brief discussion of current CIT and its main objectives. It discusses how recent trends in international taxation and digitalization have shaped recent developments in the CIT and how it has come under continued pressure to change. Subsequently, we elaborate on the destination-based cash-flow tax as a robust alternative for the current framework. Such a system would seem viable for the future as a way to sustain some form of rent tax, levied on corporations. While not imminently on the agenda, we explain how countries are driven toward such a system over time, how it can be achieved, and how equivalent developments might occur in the absence of outright DBCFTs. Subsequently, we discuss the future role of personal taxation of capital income, which could either complement or substitute for the tax on corporations.

## **The present**

Before turning to the future of the CIT, it is useful to remind ourselves of the key reasons for employing a CIT. After all: corporations cannot bear the incidence of any tax themselves, only people can –the firm’s owners, workers, or customers. Hence, if a corporation is taxed, it must have some advantage over taxing these people directly. And indeed, the generally accepted justifications for a CIT are that it allows collecting tax that would be much harder to collect directly from the owners or other stakeholders.

The CIT has traditionally served a fundamental role in the architecture of the domestic income tax system, which is often referred to as the backstop function. This can be explained as follows. It is administratively difficult to trace and tax individual shareholders on their income earned by corporations. This holds especially for capital gains, either because the value of capital is hard to assess (such as for non-traded assets in e.g. closely held corpora-

tions) or because people face liquidity constraints (they might have to sell assets to pay tax). CIT is effectively a withholding device by taxing the income from corporate profits at the firm as they accrue. This ensures that tax is collected upfront and at comparatively low administrative cost. CIT thus effectively imposes tax on retained profits (alongside distributed profits) that are not remitted to owners in the form of dividends. Through this backstop role, the CIT preserves the integrity of the personal income tax (PIT). Without CIT, individuals could defer or even avoid tax altogether by retaining earnings within the corporation rather than distributing them as dividends. CIT thus helps to level the playing field between incorporated and unincorporated businesses, which is equitable and efficient. This is particularly important in the case of foreign owners, which would be especially difficult to tax at the shareholder level.

While there is no official legal framework in international law that clarifies every detail of how MNEs should be taxed, there are some broadly accepted principles that have guided bilateral tax treaties and multilateral cooperation agreements. Notably, these principles prescribe that taxing rights on active income are generally assigned to the countries where the business activities take place (“source countries”). CITs operationalize this by taxing business profits attributable to permanent establishments, usually reflecting a physical presence. Profits are attributed to countries based on transfer pricing principles that reflect arm’s length standards (i. e., using prices for intracompany transactions similar to those prevailing between unrelated parties). Residence countries, where headquarters are based, have a secondary taxing right, and if they exercise it—that is if they apply worldwide taxation—they usually allow credits for any source-based taxes already paid. An increasing number of countries, however, in practice apply territorial tax systems, which means that they disregard active income of their multinationals earned abroad, although they can still be subject to anti-abuse provisions. Passive income, such as interest and royalties, is generally taxed in the residence country.

There are many deviations from these broad principles. Notably, withholding taxes are often levied at source on passive income. To mitigate the potential of double taxation, double non-taxation, or simply the splitting of taxing rights in contentious cases, countries can conclude double tax treaties (also known as “double taxation agreements”), which are often guided by model treaties developed by the OECD or the United Nations.

This international tax system has come under pressure in recent decades. Many scholars have studied these pressures by exploring why the current century-old system is outdated and what are its key challenges. For instance, IMF (2019) and De Mooij *et al.* (2021) distinguish four key ones. The first challenge is that MNEs have been increasingly exploiting gaps in international rules—such as transfer mispricing, intra-group financing, and the relocation of intangible—to shift profits to low-tax jurisdictions. This erodes tax bases and reduces revenues—most notably in developing countries where the capacity to enforce anti-avoidance rules is often limited. Second, countries engage in tax competition, either for profits or the actual investment of MNEs. As a result, the past four decades have shown a steady decline in statutory corporate tax rates, from a global average of around 40 percent in the 1980s to slightly above 20 percent today. Moreover, especially developing countries have witnessed a proliferation of tax incentives. This has undermined countries’ ability to raise revenue from

MNEs. Moreover, by reducing CIT rates it has also eroded the backstop function of the CIT in the domestic context –thus exacerbating domestic distortions. The third challenge is that the traditional emphasis on physical presence and the arm’s length principle no longer aligns with value creation in a digitalized economy. Especially (but not solely) for highly digitalized firms, it is simply impossible to identify what the source of profit is. This has created a deep feeling of unfairness in some countries about the allocation of taxing rights and the attribution of profits. For example, highly digitalized firms may obtain significant value from user and consumer data in market countries where they have a digital presence, but if there is no physical presence then countries cannot tax them. In response, several countries have started to introduce unilateral digital services taxes (DSTs) on the gross revenue from certain digital services, arguably to circumvent tax treaties. This, however, brings back the double taxation issue and can be associated with distortions. Finally, the fourth challenge relates to small and low-income countries with limited administrative capacity. The international tax system has become so complex that it has been hard for these countries to effectively implement and enforce commonly agreed international tax rules. Moreover, some tax treaties have reduced their source taxing rights.

These pressures on the outdated international corporate tax system have induced significant efforts for reform during the past decade, led by the G20/OECD.<sup>1</sup> In 2015, countries agreed on a list of coordinated actions to address base erosion and profit shifting (BEPS), including through four agreed minimum standards and ten non-binding common approaches (OECD, 2015). However, countries did not agree on how to cope with the challenges related to the digital economy. The OECD created the Inclusive Framework (IF) with a wider membership, which was then tasked to develop a global solution for that. In 2021, the IF Agreed on two pillars. Pillar 1 includes a mechanism to reallocate a part of profits of large (including digital) multinationals to market countries. However, this agreement has not been finalized and is currently on hold. Pillar 2 introduces a global minimum effective tax rate, which aims to address spillovers from BEPS and tax competition on profits (but not investment) more forcefully. Several, mostly advanced countries have already implemented, or are in the process of implementing, these minimum tax rules.

While these recent and ongoing reforms reduce some of the pressures on the international corporate tax framework, the system will likely continue to evolve in dealing with remaining pressures, unforeseen obstacles, and continuing tax competition and profit shifting. Ultimately, the future system will likely be driven by the robustness of each of the underlying tax principles. Among them, source-based taxation is likely the most vulnerable to spillovers, although the global minimum tax offers some relief. Alternative systems, such as formula apportionment or fixed margin regimes, can help address some of the challenges, such as reducing profit shifting. However, they can also create new ones. For instance, real tax spillovers (i. e., tax effects on the allocation of real capital) may intensify under formula apportionment if source factors are used, such as employment and assets. This can fuel tax competition even further. The other prevailing principle, residence-based taxation, is also vulnerable to spillovers as the choice of residence of the headquarters is also responsive to the local tax rules. This brings us to the alternative of destination-based taxation on which the rest of this paper elaborates further.

CIT reform during the past decade has been mainly driven by international tax competition and tax coordination. This raises the question what the implications are for the domestic backstop role of the CIT. For instance, declining CIT rates have generally increased the difference between the CIT rate and the top PIT rate on income. This may have increased the scope for domestic entrepreneurs to avoid income tax. Moreover, domestic CIT systems generally suffer from bias in favor of debt finance compared to equity finance, thereby increasing the financial vulnerability of the corporate sector. CITs also induce distortions in the level and composition of domestic investment, leading to allocative inefficiencies. While these issues have received less attention in recent years, weak growth and financial instability call for a discussion about alternative designs of CIT systems to mitigate such effects. This will be another major aspect in the rest of this paper, with a focus on rent-based taxation.

## **The future of taxation at the corporate level**

### **Destination-based taxation**

Given the growing difficulties associated with both source- and residence-based profit taxation, a fundamental reform would be to replace the current framework with one based on the destination principle, under which profits are taxed in market countries –where consumers are located. Under such an approach, neither source (as under territorial systems) nor residence (as under worldwide taxation) would determine the allocation of taxing rights or the attribution of profits.

Over time, the practical application of the source principle has become increasingly problematic. When the international tax framework was established roughly a century ago, multinational enterprises were predominantly “bricks-and-mortar” firms, with production factors such as labor and capital clearly tied to identifiable locations. Source was therefore operationalized through the concept of permanent establishment (PE), reflecting a firm’s physical presence. If a company sold goods into a foreign market, it was usually through a marketing- and distribution PE, so that some profit was collected in the country of sales. In extreme cases –such as goods with negligible production costs but market-specific markups–transfer pricing based on comparables could allocate nearly all profits to the local distributor, effectively achieving destination-based taxation while still being labeled source-based.

In today’s economy, multinational production relies heavily on intangible assets that are highly mobile, difficult to value, and easy to relocate. Some affiliates produce services for the multinational group as a whole, such as financial or engineering services, or hold intellectual property or bear the group’s risk. These developments complicate the operationalization of the source principle. Moreover, digital companies increasingly export directly to consumers in foreign markets without a PE, so that the destination country has no taxing right at all. Indeed, in the digital economy physical presence in the market country is often minimal or absent. As a result, the traditional PE concept and transfer pricing rules used to attribute profits across jurisdictions increasingly produce outcomes that have become disconnected

from commonly held notions of where profits are generated and how taxing rights over multinational profits are allocated.

In response, countries adopted a new common guidance maxim during the negotiations on the BEPS Action Plan concluded in 2015: profits should be taxed “where value is created.” This mantra, however, is subject to multiple interpretations, questioning its ability to guide reforms. For some, value creation remains closely linked to the location of physical production factors, consistent with the traditional source concept –although as mentioned above these are increasingly difficult to pin down with the rise of remote work and mobile intangibles and services. For others, value depends critically on demand-side factors –specifically, consumers’ willingness to pay. From an economic perspective, value reflects an interaction of supply and demand: without demand, value is zero; and when marginal production costs are negligible, supply is infinite and value again converges toward zero. It is the interaction between using scarce factors of production on the supply side and the marginal willingness to pay on the demand side that determines the market value of a transaction. To give a concrete example: consider a branded T-shirt that is sold for a low price in one market and a high price in another market, either due to country-specific tastes or market-specific advertising. It would be hard to argue in this case that the value in the high-price market is created in the source country. Indeed, many companies differentiate prices to different markets, reflecting the strength of demand driven by local willingness to pay.

However, the BEPS mantra has not only been difficult to operationalize under the source concept but has also opened the door to destination-based taxation. In fact, the two concepts are becoming increasingly blurred in the digital economy. For instance, digital business models often rely on user data generated by consumers in market countries (usually at no compensation), which are then used as inputs into production –for instance through algorithms trained by customer data, which are subsequently used for targeted digital advertising. In this sense, consumers themselves have become part of the production process, and the destination and source principles coincide.

In practical terms, these developments have motivated efforts to define new forms of nexus, such as “digital permanent establishments” based on significant digital sales. They are also reflected in Pillar One of the Inclusive Framework agreement, which reallocates a share of residual profits of large multinationals to market jurisdictions (the “new taxing right”). Moreover, these considerations form the motivation for digital services taxes adopted in different forms and shapes by around 30 countries.

Moving explicitly to destination-based taxation would ensure that profits are taxed in the country of final consumption regardless of corporate structure or transfer pricing arrangements. Yet because value creation cannot be precisely localized –and arguably arises partly in production countries– such reforms would depart from current principles driven by physical presence, both conceptually and operationally.

Destination-based taxation has long been the established principle of consumption taxes, such as retail sales taxes or value-added taxes. These taxes have not encountered serious

spillovers from profit shifting and tax competition, perhaps aside from some cross-border shopping. Because the destination-based approach to taxation is more robust to tax competition and profit shifting –as discussed in more detail below– it allows for more efficient design of the tax system that focuses on economic rent in an increasingly digital era.

## Rent Taxation

Rents are the part of profits that exceed a normal rate of return on invested capital. Taxation of rents is efficient because investment is not discouraged at the margin. The simplest form of a rent tax is a cash-flow tax. Such a tax allows all business-related spending –including investment– to be immediately expensed, while all sales, including of capital, are taxable. In turn there is no need to allow depreciation of capital or deductibility of interest costs.<sup>2</sup>

To illustrate the difference between a classical CIT and a cash-flow tax, consider a very simple investment of 1 to purchase capital yielding a return of  $p$  and subject to depreciation of  $d$ , which is sold after one year, with a discount rate of  $r$ . The net present value (NPV) under a CIT is:

$$NPV = -1 + \frac{1 + (p - d)(1 - t)}{1 + r} = \frac{(p - d)(1 - t) - r}{1 + r}.$$

Hence, investment is worthwhile if the rate of return net of depreciation is at least:

$$NPV > 0 \Leftrightarrow p - d > \frac{r}{1 - t}.$$

Under a cash flow tax, investment is deductible in the first period (and the tax value of losses is refundable in a multiperiod setting), yielding an immediate tax saving, and changing the NPV as follows:

$$NPV = -(1 - t) + \frac{(1 - d + p)(1 - t)}{1 + r} = (1 - t) \frac{p - d - r}{1 + r}.$$

Hence, the minimum required rate of return net of depreciation is now:

$$p - d > r.$$

Comparing the minimum required rate of return for both taxes, taxation only enters the term under the CIT. Under the cash-flow tax, investment is not affected at the margin by the tax rate, because no tax is payable on an investment that just breaks even.<sup>3</sup> In other words, the marginal effective tax rate is zero. Under the standard CIT, however, the required rate of return is raised by taxation, reducing the number of viable investment projects.

An important aspect to note is that, for neutrality to hold, firms should be given a tax refund in years when their investment cost exceeds their revenues. If no refunds are provided and firms are forced to carry forward tax losses without interest, this would erode the value of the full deduction and violate the neutrality condition. An alternative way to restore neu-

trality would be to uplift unused deductions by a statutory interest rate. However, unless this interest rate exactly matches the discount rate (including a risk premium), it will not achieve full neutrality.

An additional advantage of the cash-flow tax is that it is neutral with respect to the source of funding. This is because interest is not deductible (and interest income is untaxed). Under the current CIT, if debt had been used to fund the investment, the tax rate would be lower because of interest deductibility. In the simple model above, debt financing at an interest rate of  $i$ , yields a required rate of return of  $p - d > i$ , or in the even simpler case where the interest rate matches the firm's discount rate, the same result as under a neutral tax is achieved and the marginal tax rate is zero. In practice, however, other features of the tax system, such as depreciation allowances that exceed true economic depreciation, often lead to negative marginal effective tax rates on debt-financed investment. Either way, there is clearly a tax-induced preference for debt finance in current CIT systems. The cash-flow tax, which does not allow interest deductibility (or under the R+F version symmetrically taxes capital inflows) does not suffer from this debt bias (IMF, 2016).

The nontaxation of interest, however, does raise a question of whether the financial sector is adequately taxed. As explained in Devereux *et al.* (2021), there is no under-taxation of financial services provided to non-financial businesses, because tax is simply collected from the nonfinancial (by disallowing interest deductibility) rather than the financial sector. However, any rents earned from providing financial services to nontaxed entities, such as final consumers, would remain untaxed under an R-base cash flow tax. Applying an R+F basis to such transactions would allow collecting such rents, without imposing the complications of applying such a system on all businesses.

Another version of the cash flow tax is known as the S-Base cash flow tax (Meade, 1978). It is applied on net financial distributions, meaning that dividends and equivalent flows, such as share buybacks, are taxable, while increases in capital are deductible.<sup>4</sup> In NPV terms, it is fully equivalent to an R+F-base cash-flow tax. However, as will be discussed below, there are quite different implications under international tax competition.

A rent tax can also be designed through an allowance for corporate equity (IFS, 1991). This achieves an exemption for the normal rate of return more directly, by allowing the deduction of a notional return on the book value of equity. Provided this is set at a rate that matches a firm's discount rate, it also achieves neutrality with regard to investment. It also reduces the debt bias and in cases where the notional interest matches the debt interest, it even eliminates it altogether. Finally, it is neutral with respect to depreciation allowances. This is because accelerating tax depreciating provides a tax saving, but at the same time also leads to an offsetting reduction in the allowance for corporate equity to which the notional interest is applied.

These different forms of rent taxes are well-known, and some experience exists. Cash-flow taxes are common in extractive industries, while some forms of the ACE have been adopted in some countries (Hebous and Klemm, 2020). However, most CIT systems have not been transformed into rent taxes. One important reason is probably the international tax

environment in which CIT systems have been shaped. In the international context, governments have been reluctant to raise tax rates since it risks outbound profit shifting and loss of discrete rent-earning investments. Instead of providing relief through ACE or cash-flow taxation, governments have therefore preferred to broaden their base and lower their rates. That also explains why cash-flow taxes have been used more successfully for natural resources, which are not mobile and thus not subject to the same competitive pressures.

Without international spillovers from profit shifting and tax competition, however, rent taxes might have been more popular because any revenue loss from exempting normal returns could have been made up by higher tax rates, without discouraging investment. Hence, if cross-border spillovers can be mitigated, such as by following the destination principle, countries might be more inclined to design their CIT system as a neutral rent tax.

### **The destination-based cash-flow tax**

One way to design a destination-based rent tax is through the destination-based cash flow tax (DBCFT). Its economic properties are analyzed by Bond and Devereux (2002), while the idea was later revived in the context of the debate on international corporate tax reform (e.g., Devereux *et al.*, 2021). The DBCFT combines the features of a cash-flow tax described above with a border adjustment that removes export income from, and adds import value to, the tax base.

One of the key features of the DBCFT is that it shuts down existing profit shifting methods. As export earnings are untaxed, international transfer prices do not matter for the allocation of profits and thus manipulating them makes no difference for tax liability. Regarding imports of intermediate goods, the DBCFT can be implemented in two ways: (i) either imported intermediate goods are not deductible in determining the tax base, so that they become taxable; or (ii) they are taxed when they cross the border but then the tax inclusive cost is deductible from the tax base. Either way, the transfer price charged for the imported intermediate input has no impact on the amount of tax liable.<sup>5</sup> Also, since interest expense is not deductible (and interest income is untaxed) under the cash-flow design, related party lending is irrelevant for the allocation of the tax base within the group. More complex profit shifting schemes become also similarly moot under the DBCFT (Auerbach *et al.*, 2017).

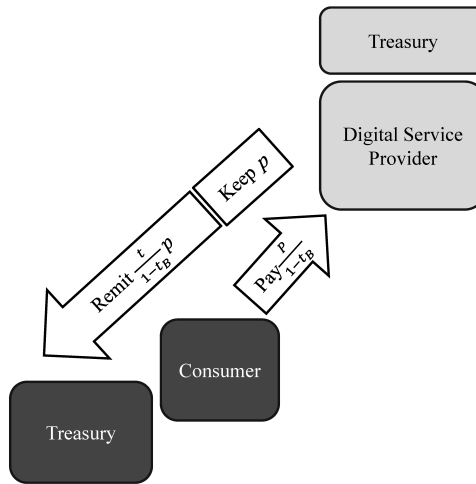
If all countries implemented the DBCFT, tax competition would largely cease to exist. This is because an MNE's tax bill would then depend only on the place of sales to consumers. Moving production or headquarters across borders would thus have no implications for taxation. Only if sales are shifted to a different country, for instance through cross-border shopping, or if consumers were to move to a low-tax country, can the tax bill of the MNE be reduced. But as consumers are generally less mobile (and are not under the control of MNEs), this effect will likely be small.

By eliminating tax competition and profit shifting, the DBCFT would also address inequities between domestic and multinational companies. Currently, multinationals often face

lower effective taxation, either because they benefit from tax incentives that are more generous in internationally mobile sectors, or because they have more profit shifting opportunities.

The DBCFT also eliminates conceptual and administrative difficulties in determining the source of profits. Determining “source” is hard when an MNE operates multiple functions in multiple countries, requiring complex transfer pricing rules that are prone to interpretation and manipulation. The location of final consumption, however, is much easier to determine and, for any sales transaction, there is usually just one destination country.

**Figure 1**  
**DBCFT FOR FEE-BASED SERVICE**



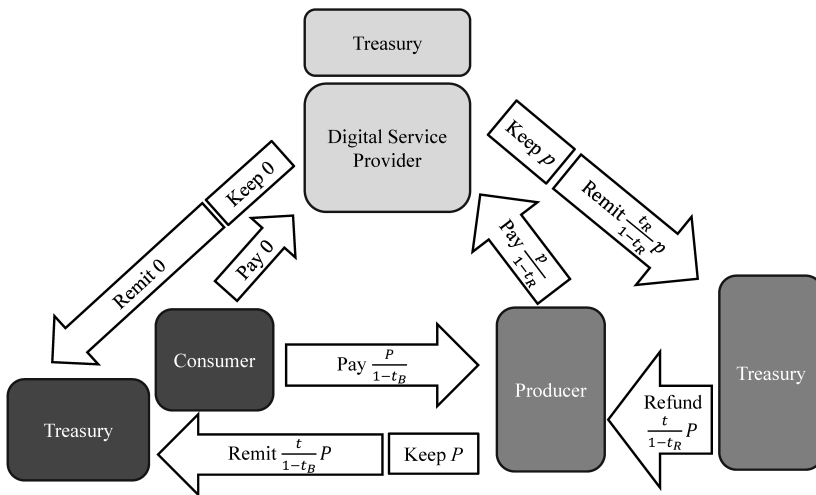
*Note:*  $p$  is the net price.  $t_b$  is the tax in the (dark grey) importing country.

As noted before, one concern with the current CIT is the taxation of the highly digitalized firms. In the case of digital services provided without a permanent establishment in a country, the DBCFT can be implemented through a simple treatment. Consider for instance the simple case of a fee-based digital service (e. g., payment to access media on a streaming device). As illustrated in Figure 1, the DBCFT is collected at the destination, that is in the importing (dark grey) country where the consumer is located –just as for any other imported good. This requires the provider of the digital service to register in the importing country of the consumer, even though it only physically operates in another, exporting, (light grey) country. Registration can simply follow current practice for VAT under the so-called vendor collection model (Brondolo and Konza, 2021), whereby non-resident suppliers are obliged to register and remit tax to the government where they sell their products.

For other digital services, the DBCFT may require a few more steps. For instance, consider a digital service that is provided for no monetary payment, yet comes in exchange for the provision of user data and exposure to advertising (such as social media platforms, or

search engines). As shown in Figure 2, with no monetary payment for the service, there is also no tax initially collected in the importing (dark grey) country of the consumer. Instead, the service makes its money by charging for advertising. The user data collected from ultimate consumers makes advertisement targeted to the (dark grey) country more valuable since a producer wishing to sell goods or services there would be willing to pay for targeted adverts. This producer might be based in yet another (medium grey) country. Initially, as the producer pays for the imported advertising services, tax is remitted to the treasury of the producer country. But that is an intermediate cost, and hence it is deductible. When the producer now sells to consumers in the dark grey country, with exports being exempt, they will receive a refund for the tax paid on intermediates. The imported good or service in turn is subject to the border adjustment tax, and hence ultimately, the revenue accrues to the destination country, just as in the simpler fee for service case.<sup>6</sup> The only exception might be adverts for services that are consumed elsewhere, such as during foreign travel.

**Figure 2**  
**DBCFT UNDER ADVERTISING-BASED SERVICES**



Note:  $p$  is the net price.  $t_B$  is the tax in the (dark grey) importing country.  $p$  is the net price.  $t_B$  is the tax in the (dark grey) importing country,  $t_R$  is the tax in the (medium grey) exporting country.

**Alternative destination based taxes**

The shift toward profit taxation in the destination country can also be done partially instead of fully as under the DBCFT. Under formula apportionment, for instance, the profits of an MNE are globally consolidated and subsequently allocated to different jurisdictions based on a formula instead of transfer prices (Avi-Yonah and Clausing, 2008; Matheson *et al.*, 2021). Such a formula may include weights based on production factors like assets, employment, and payroll and thereby mimic source-based taxation. However, to the extent that it includes final sales, it reflects destination-based taxation. The greater the weight given

to final sales in the formula, the larger is the destination element of the profit tax, and hence the greater the robustness to tax competition.<sup>7</sup> This is also demonstrated in the US experience with formula apportionment between states. States in the US can choose their own formula to apportion US-based profit. Over time, we observe a shift away from using source-based factors towards the use of final sales only (now applicable in 38 States).<sup>8</sup>

Another partial approach is so-called residual profit allocation. Under this approach, profits are split into routine profit (applying a routine return to assets or sales) –taxed at source– and residual profit (the remainder of profit, after deducting the routine profit) –taxed at the destination. Routine profit would be thus allocated using the standard separate accounting principles, while formulary apportionment would apply to the residual profits. How exactly routine and residual profits are defined can be arbitrary, but could in principle aim to resemble the economic concepts of the normal return and excess returns.<sup>9</sup> As under full formula apportionment, as long as final sales are used as one of the apportionment factors, taxation will be based on the destination principle.

The allowance for corporate equity can also be designed as a destination-based tax. Hebous and Klemm (2020) discuss how to incorporate the border adjustment into the ACE design, highlighting the need to adjust the capital and equity allowance. One general advantage of the ACE is that tax revenues would be less volatile than under a cash-flow tax. However, a drawback of the destination-based ACE is that its implementation is more complex than a DBCFT. Moreover, if the notional rate of return on equity fails to match the firm's discount rate, it will not fully remove profit shifting through debt shifting or transfer pricing manipulation of capital goods.

Finally, as mentioned in Hebous and Klemm (2021), the S-Base Cash-Flow tax will in practice be impossible to design as a destination-based tax. This is because it depends on where profit distributions take place. The S-Base could be implemented in two ways, neither of which would allow for tying tax payments to the location of final sales.

- If implementation is based on unitary taxation, it would disregard any intra-company flows. Thus, the taxing right is linked to the residence country of the ultimate parent entity, defined by its incorporation, i.e., the place from which distributions to shareholders are made –not the country of the final destination of sales. Like other corporate residence-based taxes, tax competition would remain over the location of headquarters.
- If implementation is at the level of each subsidiary, a tax is collected in each country where the subsidiary makes a profit distribution, including to its parent entity. Again, this is not necessarily where the final sales take place. Incentives for tax planning are then more extensive, as multinationals can decide where to locate subsidiaries to benefit from lower distribution taxes. For example, if a subsidiary serves a region and expects to earn an economic rent, the company can locate this subsidiary in the country with the lowest tax rate of the region to minimize the tax bill on distributions. In the extreme case, where markets could be served from anywhere –as for example in the case of digital services– there would be incentives to set up subsidiaries in low tax countries for any related online sales.<sup>10</sup>

**Why has it not happened (and should it be reconsidered)?**

Given the advantages of a DBCFT or similar tax over the current CIT based on the source and residence principle, the question arises why it has not been adopted by any country. The furthest it went in the policy debate was in the US in 2016 with the House Republican Blueprint for a destination-based cash-flow tax proposal, initiated by the United States Speaker of the House Paul Ryan and House Ways and Means Committee Chairman Kevin Brady. The proposal was intensively debated but ultimately did not become part of the 2017 Tax Cuts and Jobs Act. This section considers some of the obstacles to DBCFT adoption and how these can potentially be overcome.

***Revenue***

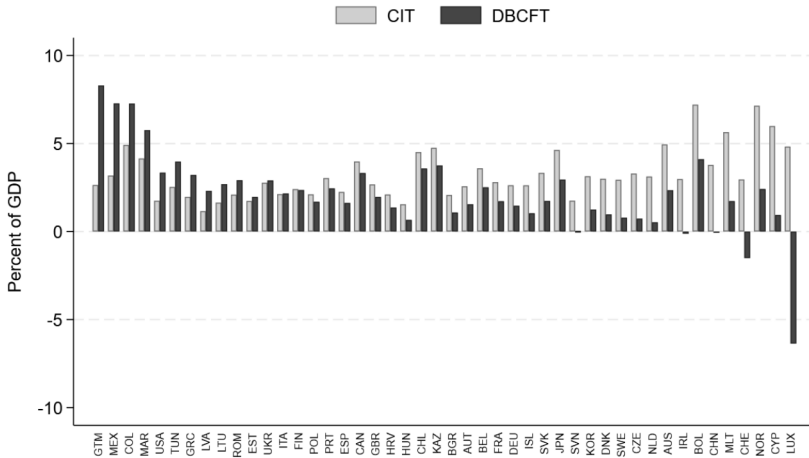
One concern is that economic rents provide for a narrower base than the CIT as the latter includes the normal return on equity. Hence, shifting from CIT to rent taxation would imply a loss of tax revenues for countries, *given an unchanged tax rate*. However, there are counterarguments to this. First, current CIT systems often end up taxing even narrower bases than economic rent, for example, where generous depreciation rules or immediate expensing are combined with interest deductibility; or where firms benefit from generous tax incentives. Second, one may expect that moving towards a DBCFT would induce important behavioral effects. For instance, the DBCFT will eliminate profit shifting opportunities, which will broaden the tax base. Moreover, by eliminating investment distortions, the DBCFT is expected to boost both the level of investment and the efficient allocation, thereby raising revenue from other taxes. Third, since the DBCFT is non-distortionary and does not suffer from cross-border tax avoidance, countries can raise the tax rate to recover revenue.

Revenue effects from replacing the CIT by a DBCFT might substantially differ across countries, however. Importantly, this will depend on the trade balance of countries. With exports exempt and imports taxed, countries with large trade surpluses will likely face large immediate negative revenue effects from the DBCFT, while countries with large trade deficits will considerably gain. Intertemporally, these effects can be expected to dissipate as countries run down their large international investment positions. However, in the short run surplus countries can face budgetary difficulties. An updated revenue analysis conducted earlier by Hebous *et al.* (2020), shown in Figure 3, reveals that some countries will end up with large revenue gains or losses. A few countries even have negative revenues under a DBCFT –driven by refunds from large trade surpluses and high investment. Clearly negative tax revenues cannot be overcome through rate increases, though they should correct over time as the investment yields return, and the foreign assets acquired through current account surpluses allow financing future imports.

Another concern is the volatility of revenue, which may be considerably larger under the DBCFT compared to the CIT. This is not just caused by the trade balance, but also because immediate expensing of investment is much more volatile than depreciation. Figure 4 shows standard deviations of corporate revenues under the CIT and under a simulated DBCFT be-

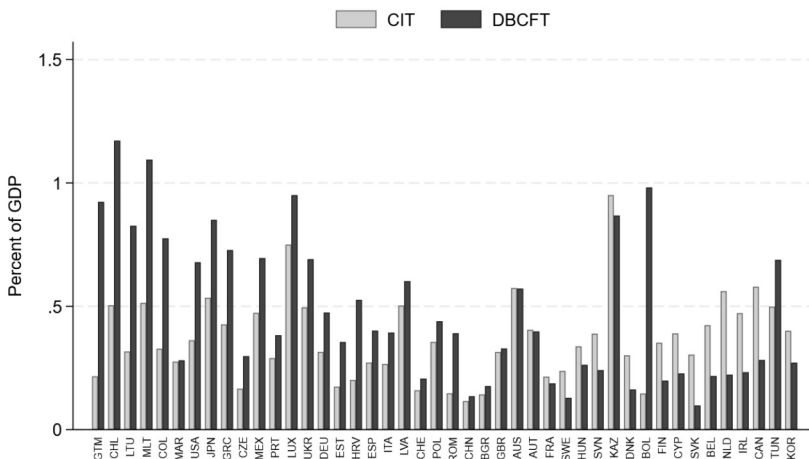
tween 2013 and 2022. For most countries, standard deviations are higher under the DBCFT, although this does not apply to all countries. Notably, commodity exporters would see a decline in volatility, presumably because the imported taxed consumption goods are less volatile than the value of exempt exported commodities.<sup>11</sup>

**Figure 3**  
**DBCFT AND CIT REVENUES (AVERAGES OVER 2013-2022)**



Source: Authors' estimates, based on WEO, WoRLD, OECD, and UN data. For the simulation method, see Hebous *et al.* (2020). Negative revenue under the DBCFT in some countries is due to large refunds provided for exporters that are not offset by revenue from domestic and importing firms.

**Figure 4**  
**STANDARD DEVIATIONS OF DBCFT AND CIT REVENUES (2013-2022)**



Source: Authors' estimates, based on WEO, WoRLD, OECD, and UN data.

Note: The chart excludes Norway, where the standard deviation for CIT revenue exceeds 4.4, possibly because of the volatile natural resource sector.

### *Income Distribution*

Another concern of the DBCFT might be its progressivity relative to the CIT. After all, the base of the DBCFT is economic rents, which is narrower than corporate profits that include the normal return on equity. However, this presumption should be qualified. For instance, as discussed before, there are ample incentives that narrow the existing base of many CIT systems. Moreover, if governments increase the tax rate under a DBCFT—which is feasible as tax spillovers become smaller—the tax burden on rents can be increased. As rents are unequally distributed and tend to be concentrated at the top of the income distribution, the DBCFT with a higher tax rate can support the progressivity of the tax system. Also, to the extent that the DBCFT were able to mobilize more revenue, it could fund higher transfers toward those at the bottom of the income distribution. Finally, as will be discussed later, the normal return could be taxed at the personal level to offset any negative impact on progressivity.

Yet, more important than the question of how much tax is paid by corporations, is that of who ultimately bears the burden of taxation. The incidence of the CIT remains one of the key unresolved issues in public finance. For instance, in a neoclassical model of a small open economy with perfect capital mobility, the incidence of the CIT is found to fall entirely on labor in the form of lower wages. This is important for equity considerations, since a higher CIT would harm workers, not shareholders. However, this result does not extend to models for a large economy that can affect world interest rates, models that include location-specific economic rents, or models with imperfect labor markets. This renders the incidence theoretically ambiguous. Empirically, several studies have tried to estimate the extent of which CIT changes are transferred into wages. While there is no consensus on exact shares of shifting, workers are often found to bear at least a significant portion of the CIT (Fuest *et al.*, 2018; Gravelle, 2013). On the other hand, the incidence of the DBCFT is comparatively easy to determine, at least theoretically (and no empirical evidence exists). As shown in Bond and Devereux (2002), the DBCFT falls on consumption financed out of non-labor income. If this theoretical result holds, the DBCFT may support equity objectives since non-labor income is generally highly dispersed toward to the top of the income distribution. A higher tax rate under the DBCFT could thus support equity objectives. Still, proponents of the global income tax might nevertheless lament the nontaxation of the normal return to capital. This point, and how to address it, will be taken up in the last section of this paper.

### *International Trade*

The border-tax adjustment under a DBCFT—exemption of exports and taxation of imports—is sometimes misinterpreted as a trade barrier.<sup>12</sup> However, economic theory suggests that a DBCFT is neutral with respect to cross-border trade. Intuitively, the DBCFT applies to all domestic sales, irrespective of whether a good is imported or produced locally, while it allows deduction of all production costs, including labor, irrespective of whether goods are exported or sold domestically. Hence, like the VAT, the DBCFT does not discriminate against trade. If a country implemented a DBCFT in exchange for its CIT, theory predicts an appre-

ciation of its currency, which would fully offset the impact of the border-tax adjustment on prices and trade would be unaffected.

To illustrate this, consider a good that can be produced domestically or imported, as well as sold domestically or exported. The good's market price is  $p$ , and the production cost is  $c$ . Any foreign quantities are marked with a subscript  $F$ . Consider the following options for the good:

- Produced and sold domestically at a net profit of  $p(1-t) - c(1-t)$ .
- Produced abroad and imported, at a net profit of  $p(1-t) - c_F(1-t_F)$ .
- Produced domestically and exported at a net profit of  $p_F(1-t_F) - c(1-t)$ .
- Produced and sold abroad at a net profit of  $p_F(1-t_F) - c_F(1-t_F)$ .

If taxes are neutral to trade, then all these profits should be the same (though they may of course differ for non-tax reasons). Setting the first and third profit equal (or the second and fourth) yields the following condition:

$$\frac{p}{p^F} = \frac{1-t_F}{1-t}.$$

Setting instead the first and second (or the third and fourth) profits equal yields:

$$\frac{c}{c_F} = \frac{1-t_F}{1-t}. \quad (1)$$

For both prices and costs to differ by the same ratio across countries, all that is needed is an exchange rate adjustment, i. e., the country introducing a higher DBCFT rate will see its currency appreciate.

Evidence from VAT reforms offers useful lessons and is broadly consistent with two central predictions: the exchange rate effect (Freund and Gagnon, 2017) and the neutrality with respect to trade (Benzarti and Tazhitdinova, 2021). Nevertheless, policymakers would need to overcome skepticism by influential importers who might doubt the offsetting exchange rate effect and thus lobby against a DBCFT. Moreover, in the case of fixed nominal exchange rates, temporary effects can be expected to persist until real exchange rates adjust (De Mooij and Keen, 2013).

### *International Coordination*

Unilateral adoption of the DBCFT by a single country is feasible but would have significant consequences for the rest of the world. It could imply, for instance, that profits are either taxed twice (if a product is produced in a country with a source-based CIT and consumed in a country with a DBCFT) or not taxed at all (if vice versa). From the perspective of business location, the DBCFT country will appear like a tax haven as it has charges no tax on profits

generated within its borders. This makes it attractive for any profit to be shifted into them, as this will not trigger any tax liability. As a result, profit shifting and tax competition would intensify, with losses incurred in countries that maintain a standard CIT. A country implementing a DBCFT on its own would thus potentially face risks of retaliation. While immune to changes elsewhere in the CIT, retaliation through other channels, such as tariffs and nontax threats, remain possible.

These spillovers from diverging international tax rules across countries are avoided if the DBCFT is part of a globally agreed reform, whereby all taxing rights are allocated to destination countries. Yet, reaching an agreement on this may prove difficult for the reasons described earlier. Compensation payments and taking a longer-term perspective, could, in principle, help alleviate such concerns. The fact that countries representing around 90 percent of global GDP agreed on the destination-based approach under Pillar One of the OECD-led Inclusive Framework agreement offers some reason for optimism. Yet, the recent hold-up in negotiations over Pillar One suggests a long and difficult road ahead, given that even a small step toward destination-based profit taxation has been facing significant obstacles.<sup>13</sup>

If a global agreement on a DBCFT is not feasible, there could still be a spontaneous development of unilateral actions towards a DBCFT. For instance, suppose one large country or a coalition of countries would move first and adopt a DBCFT. These first movers would gain a competitive advantage in attracting multinational production and profit compared to others. This would then create pressure for these others to follow suit. The ultimate equilibrium would see convergence toward a DBCFT. This scenario would be incentive compatible and the destination principle ultimately prevails.<sup>14</sup> Of course, the transition to the equilibrium could be associated with significant hurdles and costs, which can be reduced by an international agreement. Thus, coordination remains the preferable route towards a DBCFT.

### *Transitional Challenges*

Another obstacle to DBCFT adoption is the transitional challenges. First, there is a need to come up with rules for legacy assets and debt. A simple solution would be to allow immediate expensing of any remaining undepreciated assets while disallowing interest deductibility. The former, however, loses revenue on already existing capital. To avoid this, one could allow legacy assets to be depreciated over a transitional period and in parallel a yearly declining share of interest on legacy debt be permitted to be deducted. Second, if a reform is pre-announced, the currency would appreciate in anticipation of the reform, thereby distorting trade flows and during the transition. If the exchange rate is fixed, this effect would be avoided, but there would be transitional issues after the implementation of the reform as prices will adapt to the new reality and bring about a real appreciation.

### *Artificial Intelligence (AI)*

The rise of AI and related technologies, which are likely to transform jobs and human tasks, will potentially have two profound implications for corporate taxation. First, it could

increase income inequality and reinforce the case for more effective taxation of capital income, including corporate profits. The past few decades have witnessed an increase in the capital share of aggregate income and this may increase further due to rising profits and ample market power of AI-driven technology companies. To protect the revenue base, governments need to ensure that capital is adequately taxed. Moreover, as capital incomes generally accrue disproportionately to those at the top of the income distribution, this reinforces the case for effective capital income taxation. Second, AI-related activity becomes increasingly detached from physical presence and national boundaries. Indeed, digital technologies and AI are inherently intangible in nature, which challenges identifying the source of profits. This may drive governments toward pursuing the destination principle.

The DBCFT neutralizes opportunities for profit shifting by intangible-heavy companies and has the potential to raise additional revenue by reducing pressures on statutory profit tax rates. Importantly, the incidence of the DBCFT –as highlighted above– is on the owners of these technologies and the associated intangible capital. The DBCFT enables countries to obtain a share of tax revenues based on user location, rather than a hard-to-define concept of the geographic location of source.<sup>15</sup>

## **The future of taxation at the individual level**

A DBCFT would tax rents in the country of destination. But what about the taxation of the normal return to capital –which is taxed under the CIT but not under the cash-flow tax? And what about taxation in the country of the shareholder, which differs from the destination country and usually occurs through the PIT on worldwide income on residents or citizens? This section briefly addresses these questions.

### **Interactions between a DBCFT and the current PIT**

Before considering new approaches to taxing capital income under the PIT, we first discuss how the current PIT interacts with a DBCFT. While PITs differ across countries, the most common approach is that labor income and interest are fully taxed, dividends are taxed (possibly with some form of relief to mitigate double taxation), and capital gains are taxed upon realization. Combining such a PIT system with a DBCFT creates no problem for labor taxes: as labor remains a deductible cost for firms, it can continue to be taxed at the personal level, usually in the country of residence. Under the current CIT, there is often an incentive to incorporate because top PIT rates are higher than the CIT rate. This would remain under the DBCFT. However, to the extent that the DBCFT allows for a higher tax rate, such incentives for shifting income into corporations would diminish.

Interest, dividends, and realized capital gains are non-deductible under a DBCFT. To the extent that these returns reflect the normal rate of return (most clear in the case of interest), their effective tax burden under the DBCFT is zero, however. This can justify taxation at the PIT. Yet, to the extent that these returns reflect an excess return (dividends and capital gains

that exceed the normal return), they are already taxed under the DBCFT. This could be used as an argument to not tax these returns again under the PIT. The following sections elaborate further on this.

### **Taxation of the normal return**

Public finance literature generally supports the taxation of rents as this is in principle non-distortionary. However, economists differ in their view whether the normal return on capital should be taxed or not. Intuitively, a tax on the normal return increases the relative price of future consumption relative to present consumption, which distorts savings. Chamley (1986) and Judd (1985) show that, in an infinite horizon model, this is inefficient and violates horizontal equity principles. Hence, it is always better to tax only labor income and avoid the intertemporal distortion to savings by setting the optimal tax on the normal return to zero (Atkinson and Stiglitz, 1976). However, recent papers come to different conclusions, assuming different utility structures, and by allowing for incomplete markets, life-cycle motives, and human capital investment. These models offer efficiency and equity rationales for a positive capital income tax rate on the normal return (Banks and Diamond, 2010). Straub and Werning (2020) further suggest that the classical Chamley-Judd results are misinterpreted, providing further theoretical ground for the taxation of capital income under some conditions.

The key question then becomes how the normal return to capital income should be taxed. Some favor a comprehensive income tax where labor and capital income are added and taxed under a progressive tax rate schedule. Others support separate taxation of labor and capital income under a “dual income tax,” with a progressive rate scheme applying to labor income, and a flat rate applying to capital, usually at a relatively lower rate. The motivation for this lower tax on capital is that it mitigates distortions in saving and investment, which tend to be relatively severe and that a flat capital income tax does not need to be personalized, which eases enforcement by using withholding schemes.

### **Taxation of shareholders**

Instead of applying the existing PIT on capital incomes, a more refined system could be designed that would avoid double taxation of capital income (at the corporate and the personal level) as well as nontaxation of normal returns. As suggested by Kleinbard (2016), such a system could comprise of a rent tax, such as the DBCFT (or, in Kleinbard’s proposal, an origin-based allowance for corporate equity) and a tax on only the normal return to capital at the shareholder level. One way to tax this normal return at the personal level is through a net wealth tax, since it is equivalent to applying a fixed notional return to the value of net assets.<sup>16</sup> The combination of a DBCFT (to tax rents) and a residence-based tax on global net wealth (to tax normal returns) could thus be a viable alternative for the effective taxation of capital income.

However, there are drawbacks too. First, it would not be possible to tax comprehensive income at a progressive rate structure, because the rent part cannot be individualized. Indeed,

rents would be taxed at the corporate level at a flat rate of DBCFT, which cannot be differentiated by the total incomes of the (possibly many) owners. Second, a key concern of such a system is for capital importing countries that have large negative international investment positions. While the DBCFT might raise revenues in the short run in light of current account deficits, these countries will need to run future trade surpluses. This will imply that revenues in the future will fall compared to the current system. For taxation at the owner level (irrespective of whether their total income or wealth stock is covered), this equally implies a revenue loss for capital importing countries, as they will tax less capital outside their borders than other countries tax their domestic capital stock. Any related loss, however, should be weighed against the advantages of applying a tax system that is robust to the pressures the current tax system is facing. Moreover, to the extent that foreign investors exploit location-specific rents, such as natural resources, other taxes, such as royalties or ring-fenced sector-specific source-based profit taxes, can be used to extract part of the rent.

There is yet another alternative system that might be feasible in the future. Suppose that ongoing digital technology and international information exchange imply that governments can effectively determine the accrued income that individuals earn from capital, i.e. dividends, interest and capital gains—including for assets held offshore. In that case, the taxation of corporations might become redundant altogether as the government can tax all that worldwide capital income comprehensively in the place of residence (or citizenship) of the owners (see, for example, Devereux and Vella, 2017). This could have a number of advantages. For instance, capital income could be taxed at progressive rates to support equity objectives. In fact, labor and capital income could be added and income taxed under a progressive global income tax system. Moreover, tax competition and profit shifting would disappear, although it could be replaced by tax competition to attract wealthy capital owners (see Clerides *et al.*, 2025). The tax system would also be neutral with respect to organizational form and avoid arbitrage between labor and capital income. Of course, this all relies on the assumption that capital income can be assessed, and capital gains be taxed at the individual level upon accrual so that no tax at the corporate level is needed. Moreover, taxation only in the countries of the capital owners has a major drawback for poor countries that taxing rights would accrue primarily to rich countries where the owners of capital reside.<sup>17</sup> Hence, the domestic treatment of capital owners at their residence (or citizenship) might need to be combined with a DBCFT accruing to the destination countries or supplemented by specific source-based rent taxes on e.g. natural resources to serve the interest of developing countries. Implementing both a DBCFT and a personal tax on capital income would in principle be possible but would imply two taxes on rents, which should be taken into account when setting the rate.

## Conclusion

This paper explores the prospective transformative changes to profit taxation in a world of digitalization, artificial intelligence and globalization, thereby rethinking the very design of today's CIT. Our discussion underscores the need for moving toward a system that is robust and resilient to international spillovers from profit shifting, investment relocation and

tax competition. The current CIT framework appears too fragile to survive these evolving pressures. Moreover, current CIT designs induce key distortions in domestic investment and finance that are incompatible with the need for growth and resilience.

The paper argues that the DBCFT presents a stark alternative. It is inherently more robust against cross-border spillovers from profit shifting, capital relocation and tax competition. At the same time, it eliminates investment and financing distortions and is thus compatible with an agenda for growth. To serve equity objectives –particularly given how AI and related technologies may increase inequality– the DBCFT could be combined with a residence-based PIT on corporate owners. This tax could either apply to total capital income (so that excess returns are taxed twice) or apply only to the normal return to capital (e.g. by using a net wealth tax or, equivalently, a tax on a notional return on assets).

The path toward such meaningful profit tax reform demands both bold vision and sustained coordination among countries. Incremental steps, such as those considered in Pillar 1 of the global tax agreement, have opened the global debate about destination-based taxation. If global coordination were elusive, the path towards bold reform might still be pervasive, driven by the force from tax spillovers. A conceivable pathway would be by raising existing consumption taxes –notably the VAT or equivalent retail sales taxes– alongside reduced corporate and labor taxes,<sup>18</sup> which would mimic a DBCFT. Early indications of this trajectory are already visible with the growing share of VAT in the revenue base of many countries. Ultimately, a DBCFT may appear in the distant horizon, with pioneers moving first, providing subsequent incentives for others to follow. A path towards an incentive-compatible, stable new equilibrium.

## Notes

1. See OECD (2023; 2015).
2. This is the R-base cash-flow tax. Another variant, the R+F-base cash flow tax covers also all financial flows, with any funding received from loans or shareholders taxable, while any interest or amortizations are deductible. It is almost equivalent (except for interactions between the financial sector and final consumers), see Meade (1978) and Hebous and Mengistu (2024) for detailed derivations.
3. A finer point is that the cash-flow tax reduces the NPV of rent-earning investment but does not affect the rate of return. In the equation above, only  $1 - t$  is invested hence dividing the NPV by the outlay, yields  $\frac{p - d - r}{1 + r}$ , which is independent of the tax rate. If the company had invested the entire tax refund of the first period immediately, the private investment would be 1 and the combined private and government share would be  $\frac{1}{1 - t}$ . Private returns would be unaffected by tax (even the rent component) and the government would still collect revenue. However, a scenario in which a return of  $p > r$  keeps applying even on increases in investment is not realistic, as rents are necessarily limited to a unique opportunity, that is a discrete investment option. Hence, if only 1 can be invested at such rate of return, then the NPV to the private investor is indeed reduced by the tax, as long as there is an economic rent.
4. It is thus not the same as the distributed profits tax used, for example, in Estonia, which does not provide a deduction for capital increases (Das *et al.*, 2025).

5. Apart from a minor timing issue in the second implementation. Suppose a firm imports an intermediate good at a net price of  $p$  and produces a final good that it sells at a net price of  $P$ . If imported intermediates are neither taxed nor deductible, the firm will sell the good at  $\frac{P}{1-t}$  and remit tax of  $\frac{t}{1-t}P$ . If, however, the intermediate good is taxed and deductible, the firm will pay a tax on import of  $\frac{t}{1-t}p$ . When selling the final good, it will remit tax of  $t\left(\frac{P}{1-t} - \frac{p}{1-t}\right)$ . The total tax paid thus again comes out at  $\frac{P}{1-t}$ .
6. The value of tax on fees would not necessarily be the same as the tax collected on additional consumption, though. The latter is likely higher, as otherwise the digital service provider would have chosen a different business model. Moreover, even if the aggregate value is higher under the preceding argument, for any individual market it may be lower, given that the digital service provider likely faces a marginal cost close to zero and may not be willing or able to differentiate access across markets despite vastly different value of advertising services.
7. However, even if final sales are the only allocation factor, formulary apportionment is still not equivalent to a DBCFT, because implicitly it provides for the deduction of costs from all countries in the destination country (where the net profits are apportioned), while under the DBCFT costs are deductible in the source country.
8. See: <https://taxfoundation.org/taxedu/glossary/apportionment/>.
9. Some have argued that separate accounting principles should be used where transfer pricing is easy to apply, e.g. where comparables from unrelated transactions are easy to obtain (see e.g. Avi-Yonah and Clausing, 2008; Devereux *et al.*, 2021). In that case, case supernormal profits could also partly be allocated to the source (e.g., for rent-earning goods with easily available comparators, such as oil or microchips).
10. Since any profit in a foreign subsidiary must be paid to headquarters before being distributed to shareholders, there is a complex chain of taxes and credits, but ultimately only the tax rate of the subsidiary which books the profits matters. Consider a multinational that encounters a discrete investment opportunity costing 1 and yielding  $p$ . To make that investment in a foreign subsidiary subject to tax rate  $t_F$ , the firm must mobilize  $(1-t_F)$  to fund the investment (because as the funds are received by the subsidiary, they will benefit from a tax credit of  $\frac{t_F}{1-t_F}$ ). Putting  $(1-t_F)$  into headquarters, increases capital to  $\frac{1-t_F}{1-t}$ . Transferring this amount to the subsidiary triggers tax of  $t$  in the headquarters country and a tax credit of  $t_F$  in the foreign subsidiary, such that its capital reaches 1. The investment then yields  $\frac{1-d+p}{1+r}$ . Returning this to headquarters triggers foreign tax and provides a tax credit at home, such that headquarters holds  $\frac{1-d+p}{1+r} \frac{1-t_F}{1-t}$ . Paying this out to a shareholder again triggers tax, leaving a return of  $\frac{p-d-r}{1+r}(1-t_F)$ , which is totally independent of the tax rate in the headquarters' country.
11. Proposals for a DBCFT may exempt natural resource taxes so that rents from these resources can continue to be taxed in the source country.
12. This may be the case according to legalistic definitions. Consequently, some have argued that the DBCFT would violate WTO rules (see e.g. Auerbach and Holtz-Eakin, 2017 and Graetz, 2017).
13. Compared to Pillar 1, a DBCFT is relatively easier to administer as it requires no allocation formulas.
14. In a way, the observed increased reliance on VAT in many countries in combination with lower CIT rates and reduced PIT mimics exactly this gradual move towards a destination-based system.
15. Acemoğlu *et al.* (2020) propose a specific tax on automation/AI tasks –on efficiency grounds– if their net welfare loss due to labor displacement outweighs productivity benefits. But identifying and separating tasks in this way would face significant feasibility constraints in practice, and such a tax could arguably slowdown overall innovation.

16. Hebous *et al.*, 2024 compare a net wealth tax to a capital income tax and conclude that the latter is generally preferable for a number of reasons. Notably, the capital income tax covers both rents and the normal return, which makes it more efficient and more equitable. However, if rents are already taxed separately through a cash-flow tax and if the purpose is to only tax the normal return at the shareholder level, a wealth tax may be a way to implement it.
17. Of the top 500 MNEs by revenue, around 90 percent are based in advanced economies (UNCTAD, 2023). Also, OECD (2022) reports that households and institutional investors in OECD countries hold 76 percent of global equity market capitalization. These patterns are broadly consistent with U.S. statistics. For example, emerging market economies' holdings of U.S. securities is dominated by official holdings, mainly in in Treasuries, whereas advanced economies holdings are predominantly of private investors who hold equities and corporate bonds (see, e.g., Figures 4 and 5 in U.S. Department of the Treasury, 2023).
18. A VAT increase in combination with a labor tax cut is broadly equivalent to a DBCFT, because workers are compensated through high labor income for their higher consumption cost, while capital owners only face the higher VAT. However, poor members of society who pay in any case no (or little) income tax, would not benefit much from a labor tax cut while facing higher consumptions costs. They would then need to be compensated through higher transfers.

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## Resumen

Este artículo examina el futuro del impuesto de sociedades en un contexto de globalización, digitalización y auge de la inteligencia artificial. Destaca los retos que plantean el traslado de beneficios, la competencia fiscal y las distorsiones internas, que conjuntamente empujan al sistema hacia un impuesto neutral sobre el flujo de caja basado en el principio de destino. Dicho impuesto podría complementarse con un impuesto personal sobre todos los ingresos del capital o sobre el rendimiento normal del capital. Este sistema combinado tiene el potencial de mejorar la equidad y los ingresos, al tiempo que aborda las ineficiencias actuales. La cooperación internacional facilitaría la transición hacia dicho sistema, pero incluso en su ausencia, las fuerzas globales pueden impulsar los sistemas fiscales en esta dirección.

*Palabras clave:* impuesto sobre la renta de las sociedades, reforma fiscal, impuesto sobre el flujo de caja basado en el destino.

*Clasificación JEL:* H25.