Exploring Residual Profit Allocation

ABSTRACT

Schemes of Residual profit allocation (RPA) attribute the ‘routine’ profits of a multinational group to countries where activities take place and its remaining ‘residual’ profit across countries on some formulaic basis. They have received considerable policy attention in recent months, yet almost nothing is known about their impact on revenue, investment and efficiency. This paper explores these issues, conceptually and empirically. Residual profits appear to be substantial, but are concentrated in a relatively few MNEs, headquartered in few countries. The impact on tax revenue of reallocating excess profits under RPA, while adverse for investment hubs, appears beneficial for lower income countries even with weighting by destination-based sales (reflecting the greater harm they suffer from profit shifting). The impact on investment incentives is ambiguous and specific both to countries and MNE groups; only if the rate of tax on routine profits is low and the weighting factors insensitive to investment does aggregate efficiency seem likely to increase.