



Corporate Income Tax in a Small Open Economy

Gaëtan Nicodème

**DG Taxation and Customs Union
Université Libre de Bruxelles**

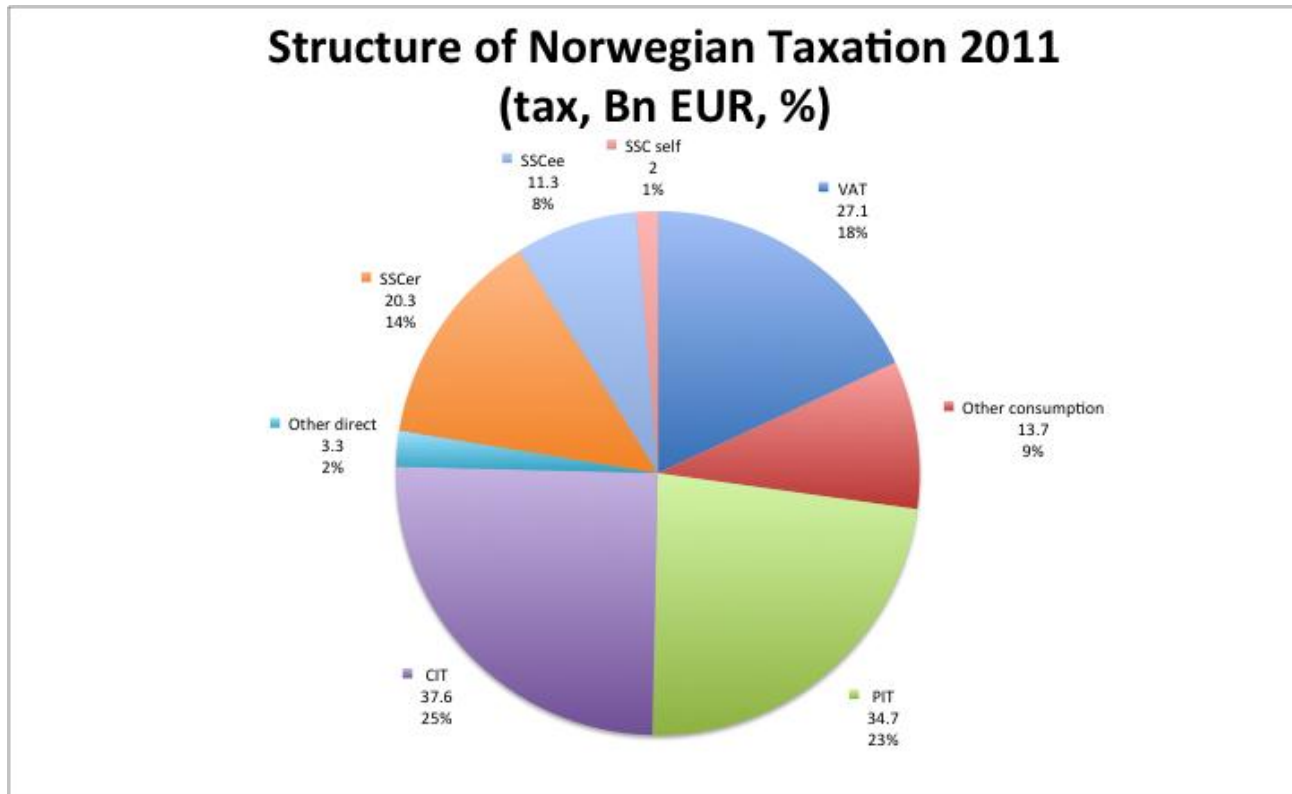
**Norwegian Tax Commission Seminar
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CAVEAT

- *Who I am: an economist interested in taxation.*
- *Who I am not: a tax lawyer, a tax practitioner.*

- *Hence: (some) knowledge in economic effects of taxation*
- *But little knowledge of nitty-gritty details of tax provisions, little knowledge in ECJ decisions, etc.*

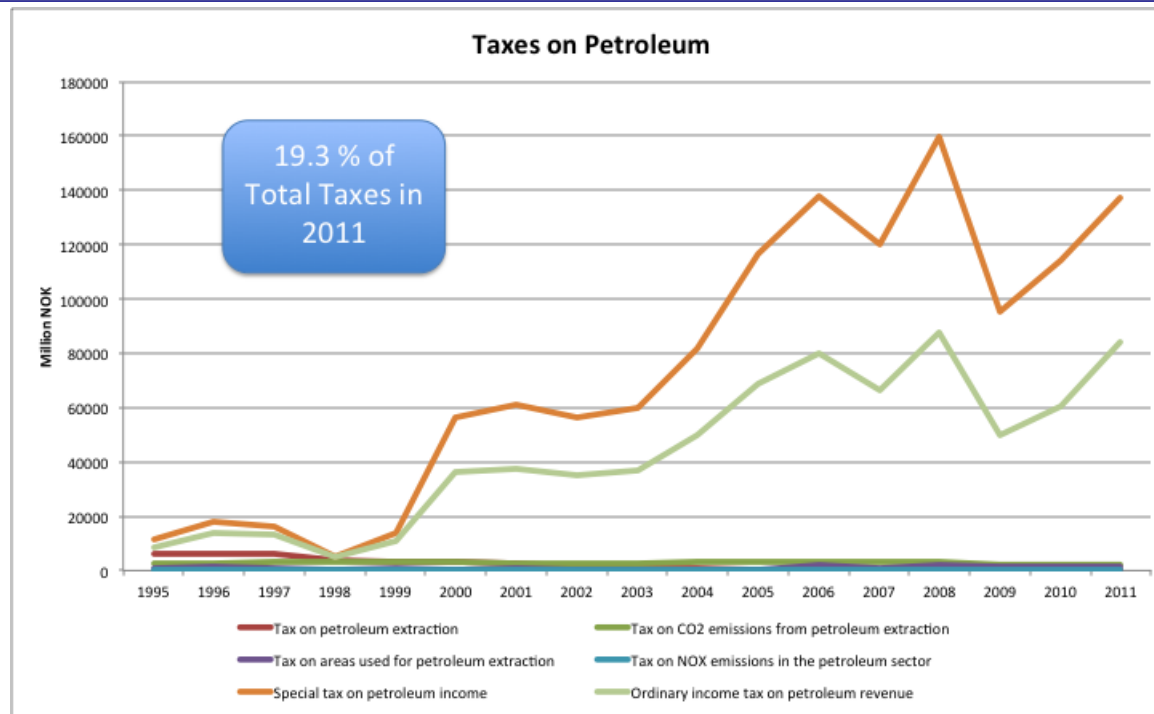
GENERAL REMARKS



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2011	NO (TAX)	NO (GDP)	EU (TAX)	EU (GDP)
TOTAL		42.5		38.9
PIT	23.2	9.8	23.5	9.1
CIT	25.1 (6.4)	10.7 (2.7)	6.4	2.5
SSC	22.3	9.5	33.5	12.7
VAT	18.1	7.7	18.4	7.1
Excises-cons	4.7	2.0	6.9	2.7
Rec. Immo	2.5	0.3	3.2	1.3

GENERAL REMARKS



SOME FACTS

- *CIT Rates: 28% (1991: 27.8%)*
- *EU27: 23.2% (below 28% since 2004)*
 - **Hence: potential for profit shifting**
- *Special Petroleum Tax: 50% on income from oil and gas production and from pipeline transportation*
 - **Tax on location-specific economic rent?**
- *Participation exemption (100% or 97%), includes capital gains*

SOME FACTS

- *Worldwide Tax System with Foreign Tax Credit*
- *Anti-avoidance:*
 - **Substance over form approach**
 - **No Thin Cap Rules (but arm's length)**
 - **CFC rules if holding >50% and t < 18.66% (2/3), unless EEA or Treaty**
 - **Transfer Pricing based on Arm's Length**
- *WT Dividends: 25%; interest, royalties: 0%*

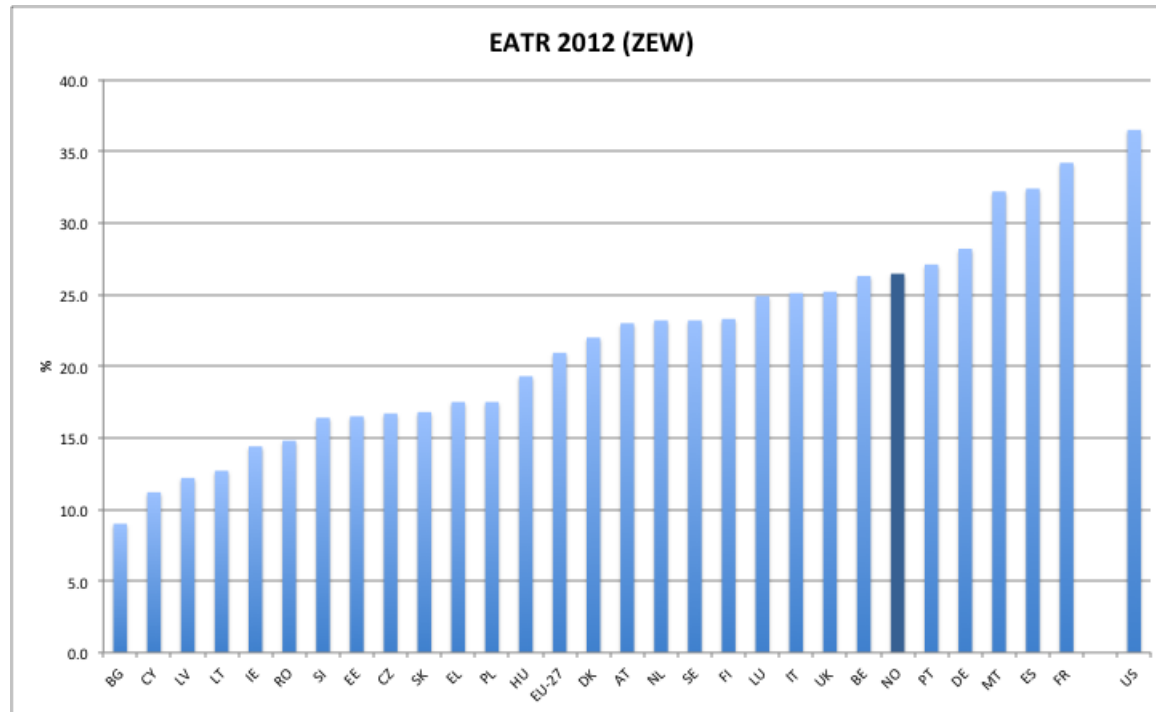
PROFIT-SHIFTING

- *Shift location*
 - **Relocate**
 - **CFC**
 - **Headquarters**
- *Profit-shifting*
 - **Manipulate transfer prices**
 - **Shift debt**
 - **IP**
- *Ambiguous effects: Mintz and Smart (2004)*

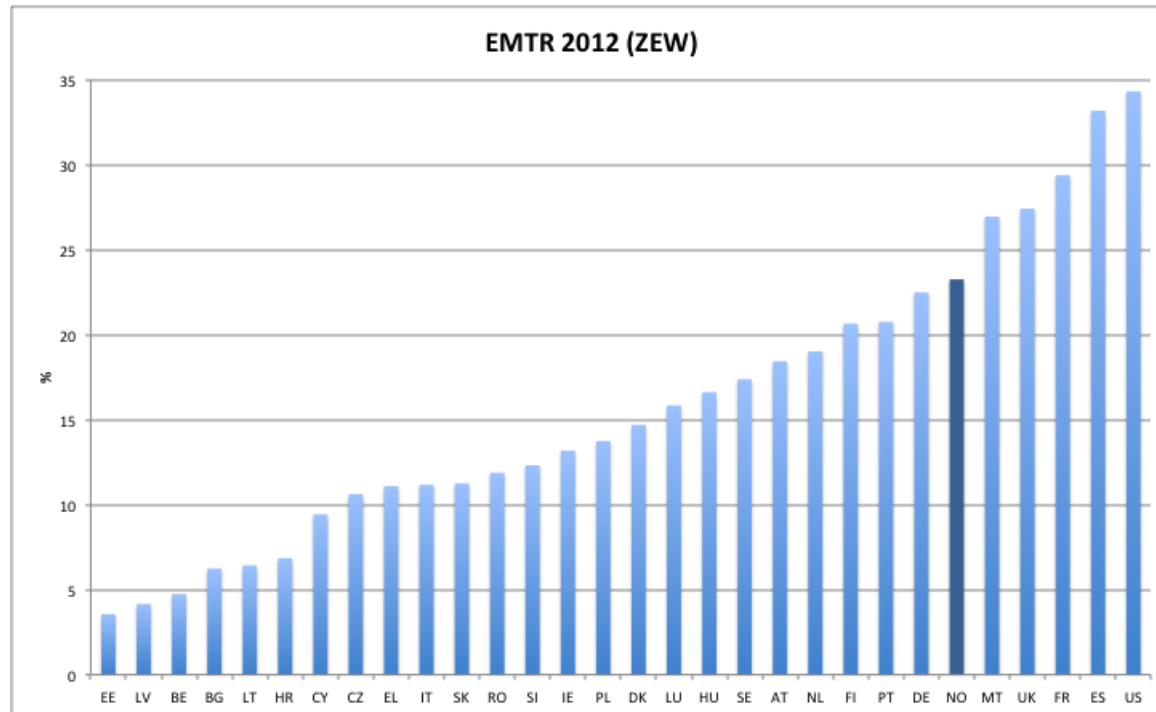
RELOCATION OF COMPANIES

- *Many empirical papers*
- *EATR matters*
- *E.g. Barrios et al. (2012, JPubE):*
 - **both host and home country tax matter**
 - **Marginal effect between -0.6 and -0.9**

EATR



Nota: EMTR (effect on FDI)



CFC RULES

- *A few papers point to efficacy: e.g. Altshuler and Hubbard, 2003 JPubE*
- *Ruf and Weichenrieder (2012 Can JE)*
 - **semi-elasticity of CFC rule of 77%**
- *Ruf and Weichenrieder (2013) look at impact of Cadbury-Schweppes ECJ ruling*
 - **CFC rule reduces passive assets by 43%**
 - **Shift from non-EU to low-tax EU countries**

RELOCATION OF HEADQUARTERS

- *Voget (2011, JPubE)*
 - **6% of MNCs have relocated HQ within last decade**
 - **CFC rules and Worldwide Taxation increase likelihood of relocation**
 - **10 pp decrease in foreign effective tax, increases likelihood of relocation by 2.2 pp (i.e. a third)**
 - **CFC positive and significant (but also acts as country dummy in regressions)**

PROFIT SHIFTING: ELASTICITY OF TAX BASE

- *Huizinga and Laeven (2008, JPubE) estimate that the elasticity of the corporate tax base to the statutory tax rate for EU is about .45*
- *Dwenger and Steiner (2012, NTJ) find 0.5 for DE*
- *Devereux, Liu and Loretz (2013) analyse bunching in distribution of taxable income at two kinks in the marginal rate schedule and find an elasticity of between 0.14 and 0.18 for companies with profits around the £300k kink, and higher elasticity of between 0.54 and 0.57 for companies around the £10k kink*

TRANSFER PRICING

- *Clausing (2000): An effective tax rate in the affiliate country 10 percentage points lower is associated with an intrafirm trade balance relative to that country that is 4.4 percentage points smaller.*
- *Swensson (2000): Statistically significant, but economically small, implying that a 5 percent reduction in foreign corporate tax rates will cause the reported price of affiliated firm imports to rise by a mere 0.024%*

DEBT-SHIFTING

- *Huizinga, Laeven and Nicodeme (2008, JFE):*
 - 32 EU countries, 1994-2003
 - **Stand-alone: 10% increase in tax rate increases leverage by 1.8%**
 - **2 equal-size related companies: 10% increase in tax rate increases leverage by 2.4% but decreases leverage in foreign affiliate by 0.6%, which indicates profit shifting**

EFFECTS OF THIN CAP RULES (and Earning-Stripping Rules)

- *Was so far limited to leverage of DE MNCs.*
 - DE reforms reduced the internal debt to equity ratio from 3 to 1.5 in 2001 and moved to a Earning-Stripping rule in 2008.
 - Wamser (2008) finds DE thin cap rules not fully effective because of substitution between external and internal debt
 - Weichenrieder and Windischbauer (2008) find similar result and point to a loophole in the legislation for holding companies
 - Buslei and Simmler (2013) find that the 2008 reform led to a decrease of the debt ratio or the split up of assets to exploit the exemption threshold

EFFECTS OF THIN CAP RULES

- *Next, another set of papers look more generally at the effectiveness of thin capitalization rules in the host countries of foreign affiliates of German multinationals.*
 - **Overesch and Wamser (2010) confirm a negative effect on internal debt based on German inbound investment data from 1996 to 2004.**
 - **Overesch and Wamser (2013) use a measure of the tightness of the thin cap rule alongside the difference in tax rates. They found a significant effect of both**

EFFECTS OF THIN CAP RULES

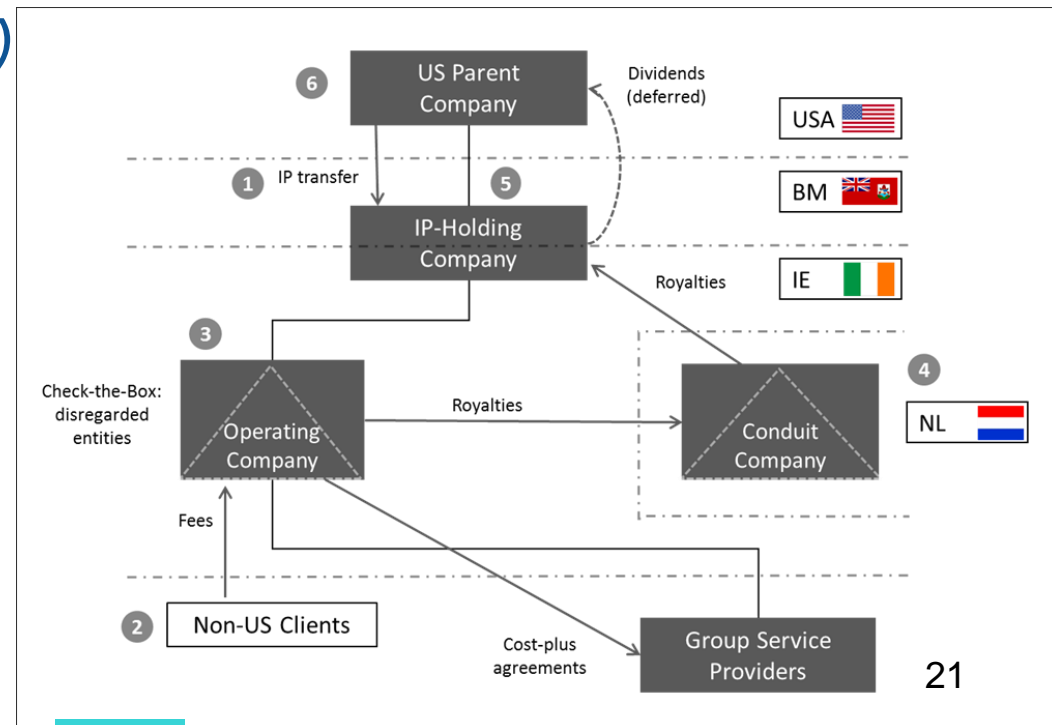
- **Buettner, Overesch, Schreiber and Wamser (2012)** use data on existence and maximum debt ratio of thin capitalization regimes in 29 countries over the 1996-2004 period. Thin capitalization rule reduces the impact of a 10% tax increase on the ratio of total debt to assets for German foreign subsidiaries from 2.1% to 1.6%.
- **But no direct control for the existence of thin capitalization rules, and thus potentially confounds the direct impact of thin capitalization rules per se with their indirect effect through a changed tax sensitivity of leverage.**

EFFECTS OF THIN CAP RULES

- *Blouin, Huizinga, Laeven and Nicodeme (2013)*
 - **US BEA data, 1980-2004, 54 countries**
 - **thin capitalization rules affect multinational firm capital structure in a significant way.**
 - **TCR on overall debt to assets reduce this ratio on average by 1.9%, while TCR on internal debt to assets reduce this ratio by 6.3%.**
 - **TCR decrease tax sensitivity of leverage**
 - **Impact is higher if their application is automatic rather than discretionary.**
 - **TCR imposed on the affiliates of US multinationals reduce parent firm valuation**

IP

- *R&D Tax Incentives, Patent boxes and structures (see Fuest et al. 2013)*
- *Discussions in Code of Conduct Group*



IP

- *Dischinger and Riedel (JPubE, 2011): Negative relationship between CIT rate of subsidiary and level of intangible assets holding*
- *Karkinski and Riedel (JIE, 2012): Negative relationship between number of patents and CIT rate*
- *Griffith, Miller and O'Connell (2011): CIT has a negative effect on likelihood of IP firms to locate. Policy simulation shows: everybody loses in tax revenues if patent boxes*

CCCTB

- *2011 proposal*
 - **No TCR**
 - **Art 73: Switch-over clause: no exemption for dividends, proceeds of disposals of shares, income from foreign PE if CIT rate is lower than 40% of EU average or if special regime of substantially lower level of taxation**
 - **Art 80: GAAR ("artificial transactions, sole purpose of avoiding taxation")**
 - **Art 81: Disallowance of interest deduction if no IE (2011/16/EU) + one of 2 conditions in art 73. But Arm's Length**
 - **Art 82: CFC: 50% holding, <40%EU or special regime, not quoted, 30% revenue is div, int, royalties, etc.**

CCCTB: current discussions

- *Interest Limitation Rule?*
- *Safe Harbour Rules?*
- *Broader CFC?*
- *Strong GAAR?*