

FDI and Corporate Taxation in the EU

Prof. John Vella

Centre for Business Taxation, University of Oxford

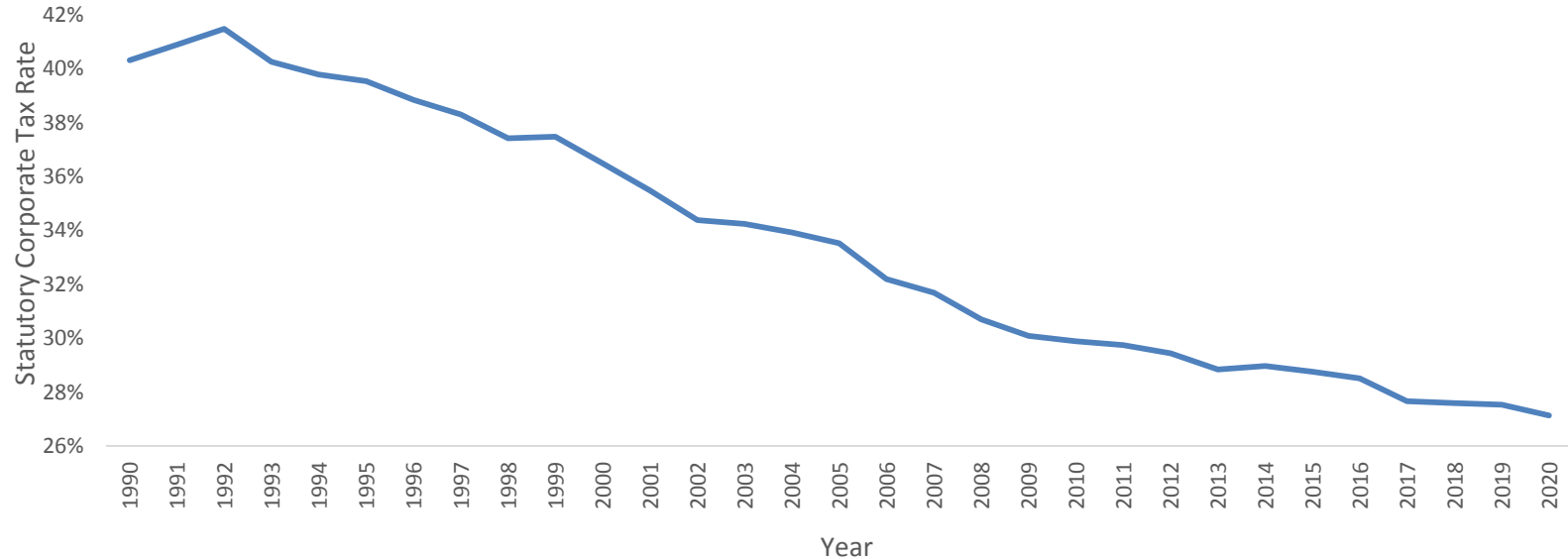


Corporate Taxation and FDI

- **Current CT regimes distort FDI location decisions**
 - Source based tax (broadly defined)
 - States use the tax system (rate and base) to compete over FDI
 - Global perspective: undesirable
 - Domestic perspective: has benefits *but* race to the bottom

Corporate Taxation and FDI

Figure1. G20 Average Statutory Corporate Tax Rate



Source: *Devereux, Habu, Lepoev and Maffini (2016)*

Corporate Taxation and FDI

- **Period of unprecedented CT reform**
 - Primarily driven by concerns over profit-shifting
 - Through intra-group transactions (e.g. debt-shifting, IP in tax haven)
 - OECD (2015): \$100bn-\$240bn p.a.
 - Reform: OECD, EU and US
- **Presentation focuses on future**
 - What impact will CT reform have on FDI?

Presentation Outline

- I. Empirical Evidence
- II. OECD/G20 - Base Erosion and Profit Shifting (BEPS)
- III. EU Commission - Common Consolidated Corporate Tax Base (CCCTB)
- IV. USA - Destination Based Cash Flow Tax (DBCFT)

I. Empirical Evidence

- Survey of empirical evidence – Voget (2016) – www.etpf.org
- **Current CT regimes have an impact on FDI**
- Decrease in statutory CT rate by one percentage point:
 - Increases *number* of MNEs hosted by about 2.5%
 - Increases *asset size* of MNE affiliates by about 1.6%
- Greenfield investments react more strongly to taxes than cross-border acquisitions

II. OECD/G20 - BEPS

- OECD: *“the most significant re-write of the international tax rules in a century”*
- Final Reports - 5 October 2015 - 15 Action Points
- Close/narrow loopholes – fundamental structure unchanged
- Harder (not impossible) to shift profits
- EU implementation – e.g. Anti Tax Avoidance Directive (2016)

II. OECD/G20 - BEPS

Impact on FDI?

i. Location of real activity

- Close profit shifting channels – increase need to move real activity
- E.g. Action 5 – Patent Boxes (PB)
- Pre-BEPS MNE could undertake R&D in A and transfer IP to B to benefit from B's PB
- Post-BEPS must undertake R&D in B to enjoy B's patent box

ii. Rate competition

- Competition on base dampened: could competition on rates intensify?
- France, Japan, Italy, UK recently announced headline rate reductions
- System remains unstable – race to bottom continues

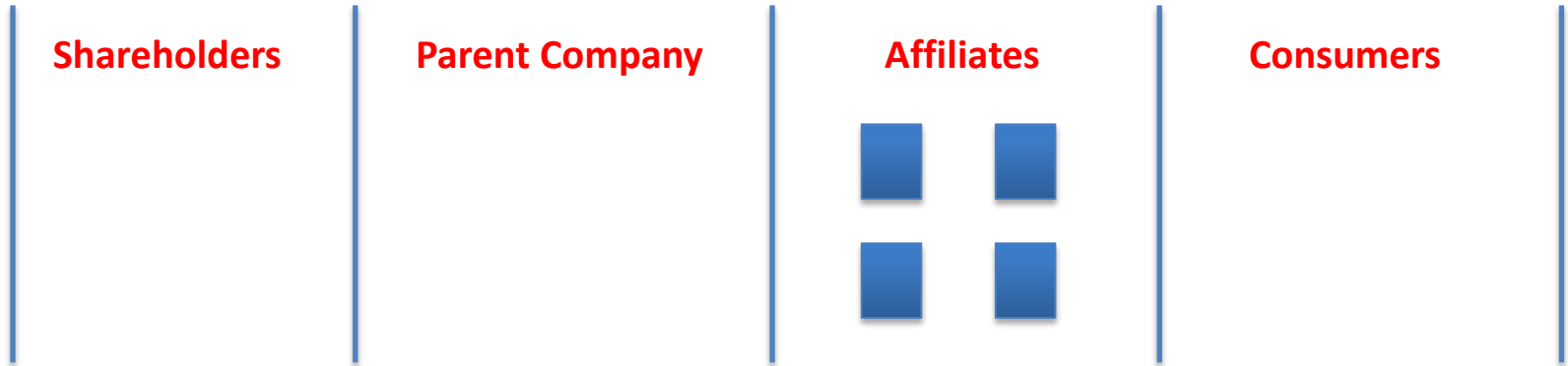
III. EU - CCCTB

- Re-launched in October 2016
- Unitary taxation and formulary apportionment
- Three factor formula (labour, assets and sales)
- Pros and cons
 - Main pro: eliminates tax planning through intra-group transactions w/in EU
- Adoption? Strong Commission/Parliament support – impact of Brexit?
- **Impact on FDI?**
 - CT will continue to distort FDI
 - MNEs have incentive to locate labour and assets in low tax countries
 - Countries have incentive to compete on rates to attract related FDI
 - Downward pressure on rates continues

IV. USA - DBCFT

- **Could be game changer!**
- Academic writing: Bond & Devereux (2002); Auerbach (2010); Auerbach & Devereux (2012), Auerbach, Devereux, Keen and Vella (2017)
- House Republicans Reform Plan – 24 June 2016
- Basic idea:
 - Tax multinationals in relatively immobile location: consumers
- Two elements:
 - Cash flow tax (falls on economic rent)
 - Destination basis (tax imports/exempt exports)
- Ultimate tax competition move - source based tax reduced to zero
- Many attractive properties... but...

Corporate Taxation and FDI



IV. USA - DBCFT

- If adopted **universally**:
 - **will *not* distort location decisions – *no* impact on FDI**
 - robust to common tax planning techniques
 - stable: stops downward pressure on rates
- If adopted **unilaterally**:
 - **distorts location decisions *in favour* of DBCFT country – imp. impact on FDI**
 - common tax planning techniques open ***but not vs DBCFT country***, problems for other countries exacerbated
 - MNEs have incentive to locate in DBCFT country and other countries have incentive to follow suit

IV. USA - DBCFT

- **If adopted, very significant issue for the EU!**
- Likelihood of adoption?
- How should EU respond?
 - Defensive measures?
 - Challenge under WTO rules?
 - Consider DBCFT rather than CCCTB?

Thank You

