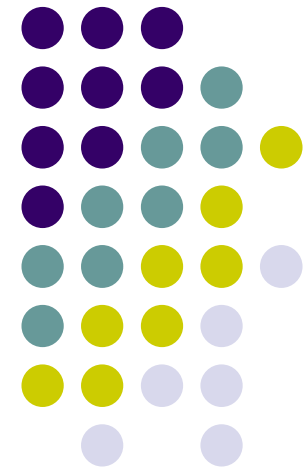




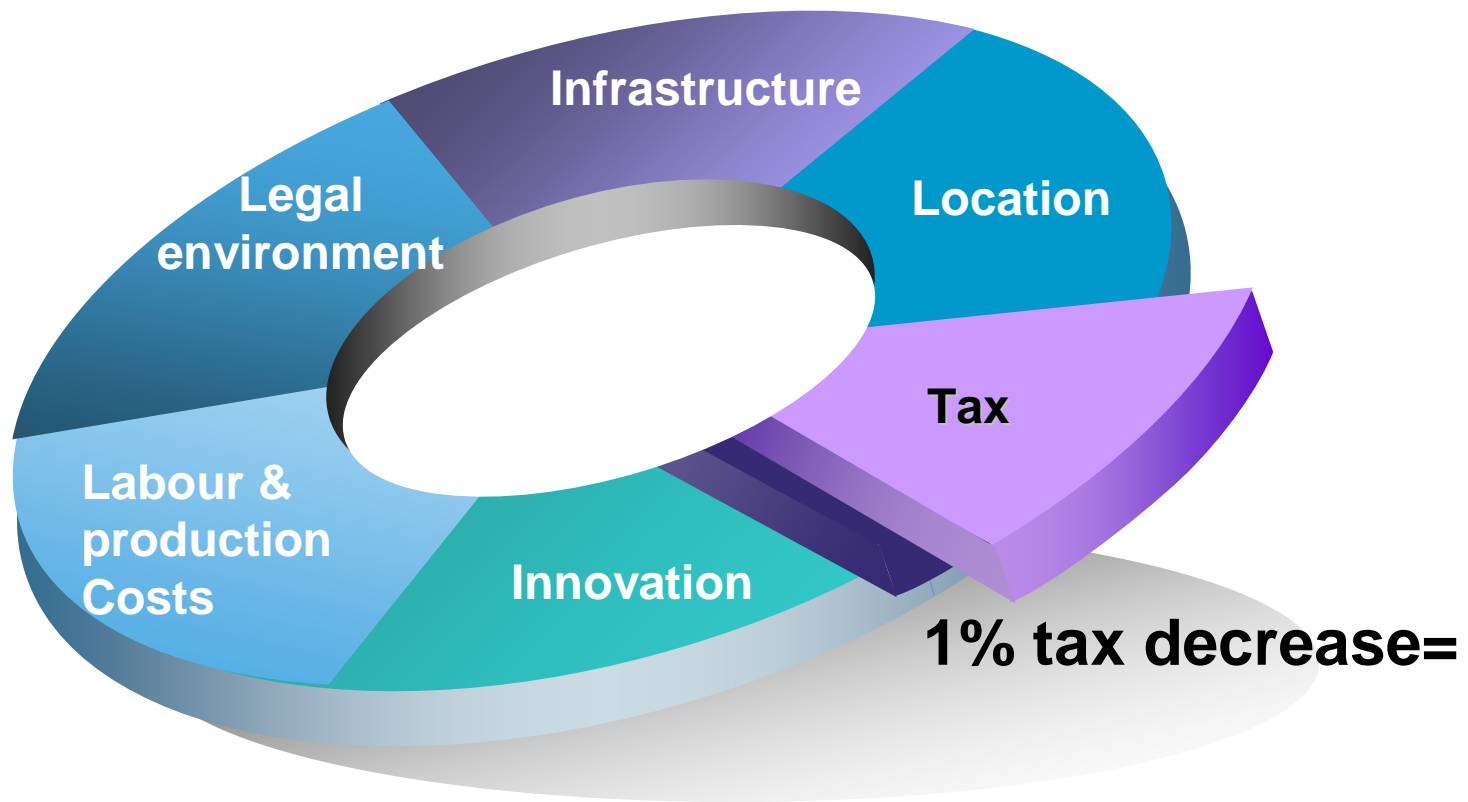
<http://www.fse-agire.com/>

# Role of fiscal policies in the process of restructuring

AgirE Conference  
Florence, 4-5 June 2007  
Barbara Gabor (researcher, EUI)



# Taxes and restructurings



**3.1% more foreign direct investment**

# Outline of presentation



1. National tax policies - Firm's reaction
2. EC policies' impact on tax competition
3. Further EC policy action: possibilities

# Taxes: States' perspective



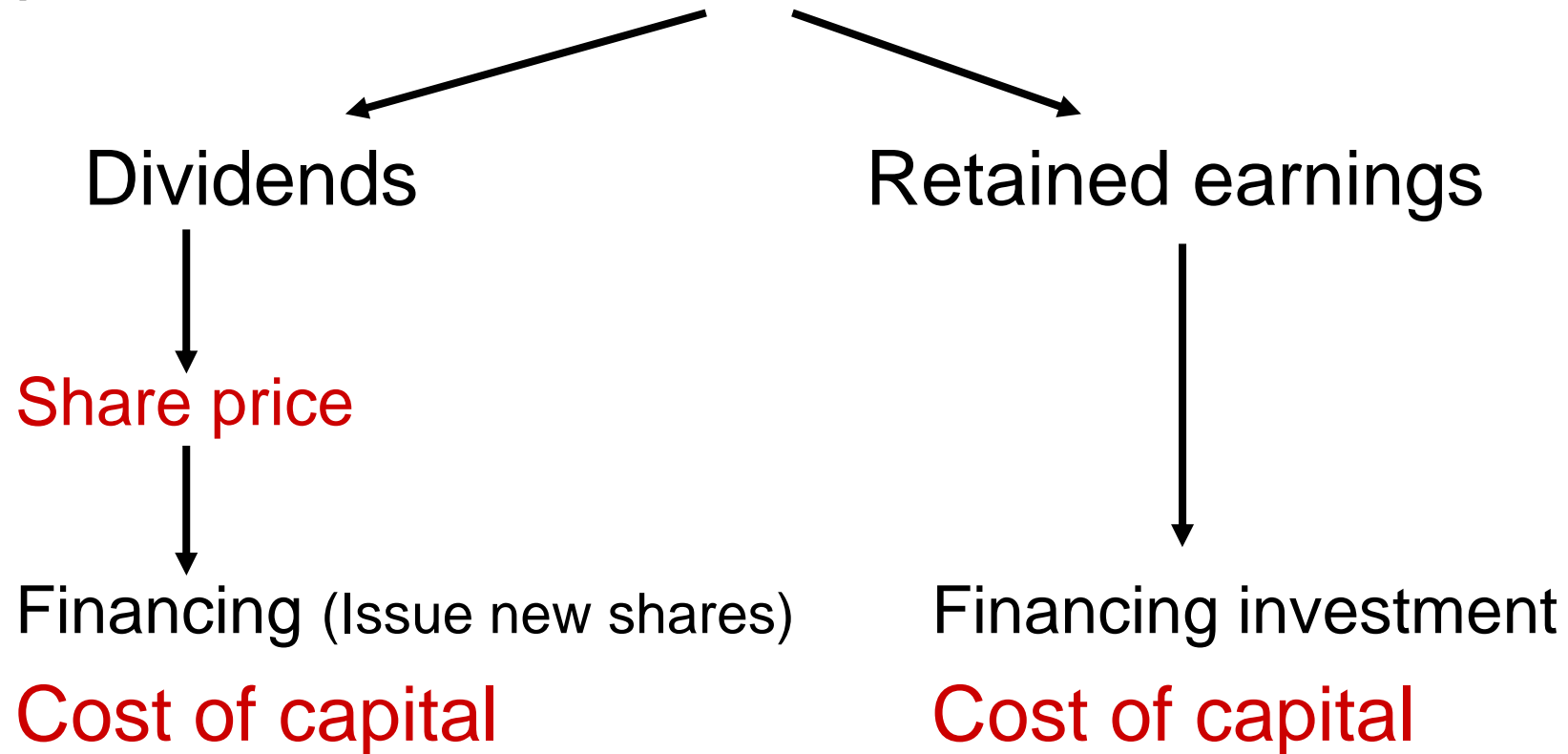
- TAX = Revenue for
  - Provision of public goods
  - Redistribution and social policy
- Tax competition:
  - Host State (+) Lower taxes attract more firms
  - Home State (-) Lower capital income tax →  
higher labour income tax  
OR  
limited social policy

# Taxes

## Firms' perspective



profit – tax = AFTER TAX PROFIT





# Tax strategies – a typology?

- Changing residence-tax jurisdiction:
  - Seat transfer (CARTESIO pending case)
  - Re-incorporation
- Legal form:
  - Liquidation of existing subsidiary production sites; establishing new / or acquisition of existing plants
  - Reorganization of existing branch production sites
  - Merger with relocation (SE; Sevic System; cross-border merger directive)

# Stages of financing decisions on location and investment



	1st stage	2nd stage	3rd stage	4th stage
<u>Decision</u>	<b>Locate abroad?</b>	<b>Where to locate?</b>	<b>How much to invest?</b>	<b>Reinvest or pay out?</b>
Tax Influence	Effective average tax rate	Effective average tax rate	Effective marginal tax rate	Effective marginal tax rate
Employees affected	(-) home state	(+) host state	(+/-) extent	(+/-) future growth
Type of decision	Discreet	Discreet	Continuous	Continuous

# Forms of tax competition



- Tax competition:
  - To attract profit through *Statutory rate*
  - To attract firms *through Effective average rate*
  - To attract capital *through Effective marginal rate*

(Devereux et al.)

# Taxation – two potential impacts



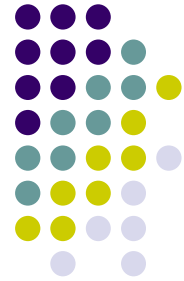
- Taxes induce relocations
  - Tax competition – more incentive to relocate
  - States attract firms with low tax rates  
(ST Micro - China)
- Taxes deter relocations
  - Exit taxes – upon company leaving jurisdiction
  - Exit tax restricts EC Treaty freedoms

# EC policies' influence: Legal framework of taxation



- National tax laws
  - National competence in setting tax policies
  - EC Treaty should be observed
- EC harmonization
  - Directives
  - Soft law (Code of Conduct)
  - New proposals (Common Consolidated Corporate Tax Base)
  - European Court of Justice (ECJ) case law

# EC level: directives and soft law



- Directives (*cover only certain cross-border transactions*):
  - Cross-border mergers
  - Cross-border dividend payments= *facilitate mobility*
- Code of Conduct on Business Taxation:
  - Special tax advantages not allowed
  - General tax advantages (e.g. *lower tax rates*) allowed= *allows tax competition*

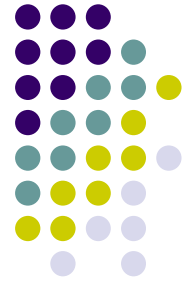
# EC level: proposed CCCTB



- Harmonize tax base
  - Leave national competence to set tax rate
  - Allocation of profit each state can tax:
    - Depends on number of employees, capital, sales,
  - Advantages:
    - No compliance costs, no profit shifting, more certainty
  - Disadvantage:
    - Exploitation of formula by relocating economic activity
- = allows tax avoidance by relocation*

# ECJ case law: Treaty freedoms

## – tax sovereignty



- Restricting Treaty freedoms
  - Possible but strict criteria imposed
- Tax avoidance allowed if:
  - Economic activity transferred (Cadbury)
- Exit taxes
  - May be eliminated in future (Daily Mail / X and Y)

= *Case law allows tax avoidance by relocation, facilitates mobility*

# Prediction of future tendencies



- **EC directives** lead to higher cross-border mobility
- **Code of Conduct** allows tax competition
- **ECJ case law** leads to higher cross-border mobility and allows tax avoidance by relocation
- **European policy** in general restricts tax evasion, allows relocation of economic activity(tax avoidance)
- **Market integration** leads to higher tax sensitivity of foreign direct investment

# Taxation – two potential impacts

- Taxes induce relocations  
Tax competition – mobility of firms

**EC law in this direction!**

- Taxes deter relocations  
Exit taxes – restricted mobility



# National or EC policy action?



## National action

- **National sovereignty** in direct tax legislation
- **No harmonizing** rules in EC Treaty
- National action unlikely: coordination and trust problems

## EC Action

- **EC Treaty** to be respected
- **Subsidiarity** principle *if objectives not sufficiently achieved at State level*
- What is needed for EC action?



# EC policy action

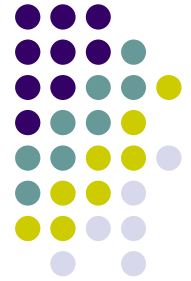
## Legislative action:

- Economic approach requires to show:
  - Impact of tax policies on employees
  - Costs outweigh benefits
- Legal approach requires to show:
  - *EC Treaty goal* cannot be achieved by States
  - Can be better achieved at EC level

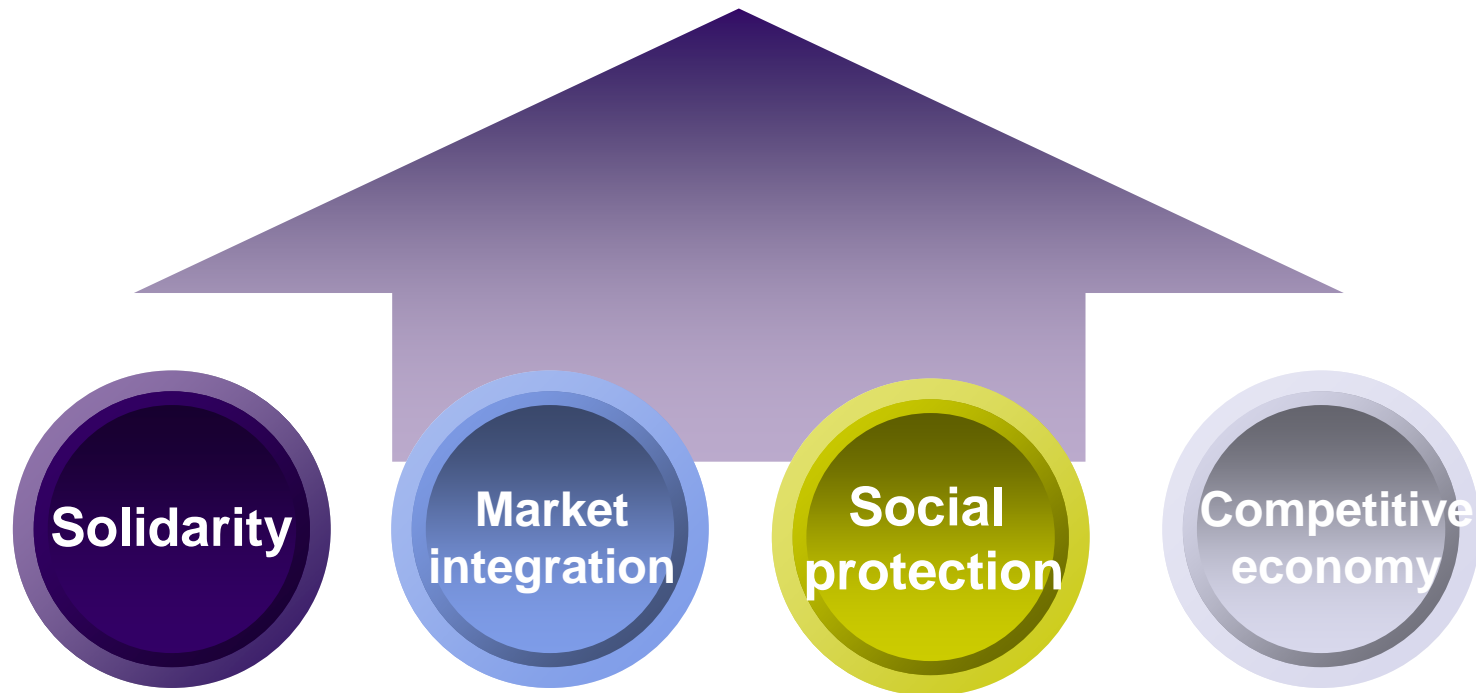
## Re-interpreting present legal standard?:

- “Take account of EC Treaty” in national tax policies
- *Goals of EC Treaty*

# Goals of the EC Treaty: Equal or hierarchical?



European Community



# Equal goals – theoretical approach



Phase 1

Phase 2

Phase 3

Efficient  
allocation of  
resources

Fair  
redistribution  
of benefits

Competitive  
economy  
with  
solidarity

# Exit tax as tool for redistribution?



Justification for restricting EC Treaty freedoms:

- “**Loss of tax revenue**” *national policy goal* is not accepted by Court
- “**Social protection**” as an *EC law justification*?
- Treaty interpretation: Equal or hierarchical goals?
- ECJ case law or EC legislation to fund protection of employees?



# Conclusion

- **National taxes** influence restructurings
- **EC level policies** enforce this influence
- **Tendency** towards stronger effects in future
- **National policy action** unlikely  
(coordination and trust problems)
- **EC policy action** in tax field unlikely (market integration focus)
- **Tax as funding** Would equal goals approach justify EC policy action in the field of taxation?

**Thank you  
for your attention**

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