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The Impact of Tax Avoidance in the European Union

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Abstract

In the context of contemporary debates on fiscal and economic policy, the impact of tax avoidance in the European Union was a frequently discussed topic at the negotiating table.

In this paper, we followed the inflows of foreign direct investments and corporate tax collected to the state budget, trying to find out if a state with a high tax rate from the European Union could have an amortized impact of profit shifting, due to foreign direct investment inflows, also tracking how the corporate tax collected at the state budget changes, as the respective state reduces taxes.

Following the research, we found out that paradoxically, as the state decreased the tax rate, corporate tax collected increased and also in certain years, the level of foreign direct investment exceeded corporate tax collected, which would indicate an amortized impact of tax avoidance.

Key words: tax avoidance, European Union, foreign direct investment, corporate tax
J.E.L. classification: F21, F23, H26

1. Introduction

In the context of contemporary debates on fiscal and economic policy, the impact of tax avoidance within the European Union, as well as globally, has been a frequently addressed topic at the negotiation table, having significant implications for both member states and for the integrity and efficient functioning of the community block.

Globalization and economic integration have allowed companies to expand globally and have the opportunity to employ profit-shifting strategies in jurisdictions with lower tax rates. This practice has been a major concern for the European Union as well as globally, as it undermines the principle of tax fairness and affects the ability of states to mobilize financial resources for the economy and society.

The latest approach to tax-shifting strategies is found within the OECD/G20 initiative aimed at establishing a global tax uniformity. This initiative involves allocating a part of the profits generated by a multinational company to the country where it was made, along with setting a minimum global tax rate.

In order to determine a real impact of profit-shifting strategies on the European Union, it is also important to take into account the advantages generated by the presence of multinational companies in a state, of great importance being the contribution of foreign direct investments.

Certainly in high-tax countries, multinational companies will apply various strategies to reduce the tax base, but this loss could be compensated, at least in part, by inflows of foreign direct investment.

Therefore, within the framework of this paper, we have proposed to follow the evolution of foreign direct investments and corporate taxes collected in France, a member state of the European Union, taking into account the high tax rates.

The purpose of this paper is to determine whether the evolution of foreign direct investment from the European Union states is significant to partially compensate the impact of tax avoidance in the European Union.

Certainly, the situation must be handled differently, depending on the particularities and market of each state. Therefore, the question would arise, why would a multinational company not invest in a state that has a promising market, even if it has a higher tax rate, given that it could apply profit shifting strategies? If the company even so invests in a state with a high tax rate, would the foreign direct investment at least partially offset the profit transferred?

In this context, if the reform plan proposed by the OECD/G20 would reduce tax avoidance, would it reduce foreign direct investment in states with a high tax rate, so that a positive result attracts a negative one?

This paper is a part of a larger research through which we aim to determine the impact will have the new tax reform plan proposed by the OECD/G20 in the European Union. Therefore, this paper has the role of drawing the major aspects that we must keep in mind.

2. Literature review

Extensive empirical research indicates that foreign direct investment (FDI) by multinational enterprises (MNEs) is negatively influenced by profit taxation, showing a significant decline in both the location and size of these investments when taxes increase (Egger, Merlo and Wamser, 2014).

In another paper, analyzing the traditional structure of foreign direct investment (FDI) data, it was observed that they fall immediately in response to the higher tax rate, but it cannot be definitively concluded whether investors, faced with high burdens, seek to avoid them through some third countries. Taxes have been found to influence the choice between a direct or indirect investment route (Erokhin, 2023).

Therefore, there are opinions regarding the inflow of foreign direct investment into countries with high tax rates, either directly or indirectly.

With regard to taxation, since the 1990s, academic studies have focused on empirically identifying tax-motivated profit shifting, noting that US foreign subsidiaries are less profitable than purely US firms, a phenomenon partly explained by special characteristics of foreign firms such as be it younger age or special post-purchase depreciation. It is suggested that the remaining difference in profitability is due to profit shifting activities. In addition, it has been shown that profits from sales of US subsidiaries are higher in low-tax countries compared to high-tax countries (Weichenrieder, 2009).

It is a well-known fact in the specialized literature and globally, given the interests of the tax avoidance approach, that Multinational Enterprises (MNEs) resort to tax havens to profit from international tax arbitration and to improve the efficiency of their capital. These practices are seen as distorting global financial markets and eroding national tax bases, often becoming subjects of media interest. However, MNEs continue to diversify their activities in tax havens, investing in multiple such jurisdictions (Jha and Awate, 2022).

In another paper, foreign direct investment (FDI) in developing countries has been found to be positively influenced by FDI in neighboring tax havens. However, this assumption is undermined by uncertainties related to the nature of FDI, that is, whether the investments are real or the result of tax avoidance practices. In addition, it is important to consider the possibility of developing countries borrowing money from the financial institution located in tax havens to support their savings, which would influence the data on the level of FDI in these countries and the origin of investments (Chiari, 2023).

3. Research methodology

In this paper we aim to find out if the evolution of foreign direct investments from European Union states is significant to partially offset the impact of tax evasion in a European Union state with a high tax, namely in France.

We thus propose a descriptive research through which we will collect and classify the data to analyze them in a historical context by comparison, trying to describe the events that could have caused a change in the evolution of the data. The data we have in mind refer to the evolution of the corporate tax rate, the evolution of corporate tax collected to the state budget and the evolution of foreign direct investment inflows from France.

What we are looking for is to find out if a reduction in the tax rate has a change in foreign direct investment inflows and also if France, which is a country in the European Union with a high corporate tax rate, has an upward evolution and significant increase in foreign direct investment, so that it can at least partially offset the profit-shifting activity of multinational companies.

4. Results

In the following table, we will present the data we collected regarding the evolution of the corporate tax rate in France.

Table no.1. The evolution of the corporate taxation rate in France in the period 2013-2022

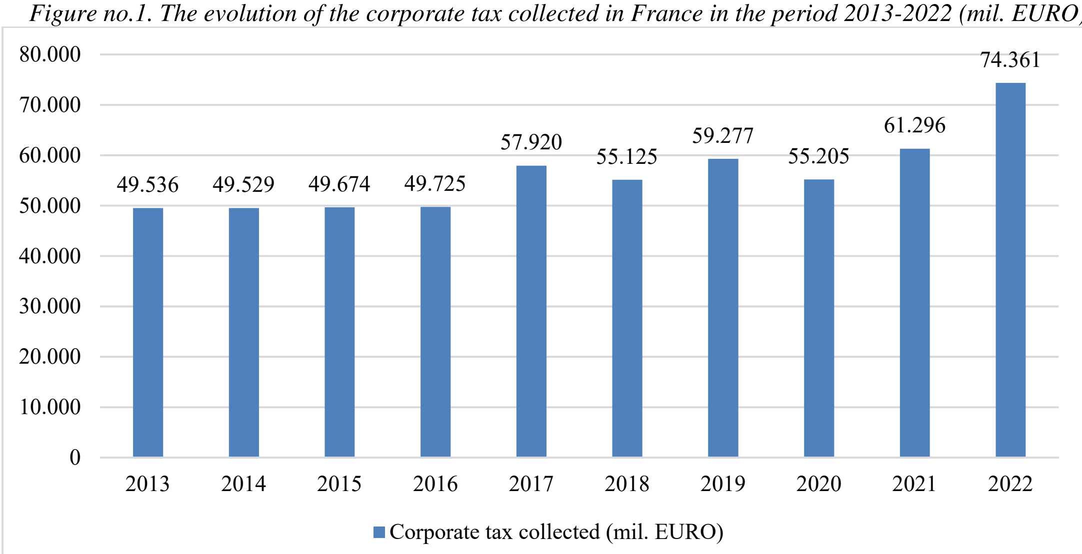
Country	2013 (%)	2014 (%)	2015 (%)	2016 (%)	2017 (%)	2018 (%)	2019 (%)	2020 (%)	2021 (%)	2022 (%)
France	33.33	33.33	33.33	33.33	33.33	33.33	31	31	27.5	25

Source: European Commission, TEDB - "Taxes in Europe" database

According to Table no.1., in France, the corporate taxation rate remained constant during the period 2013-2018 at a level of 33.33% and from the year 2019 a downward trend began from the percentage of 31% in the year 2019 to a percentage of 25% in 2022.

Regarding the corporate tax collected at the state budget in France, we have collected the data and centralized them in a graph, as follows:

Figure no.1. The evolution of the corporate tax collected in France in the period 2013-2022 (mil. EURO)



Source: Eurostat, Tax revenue statistics

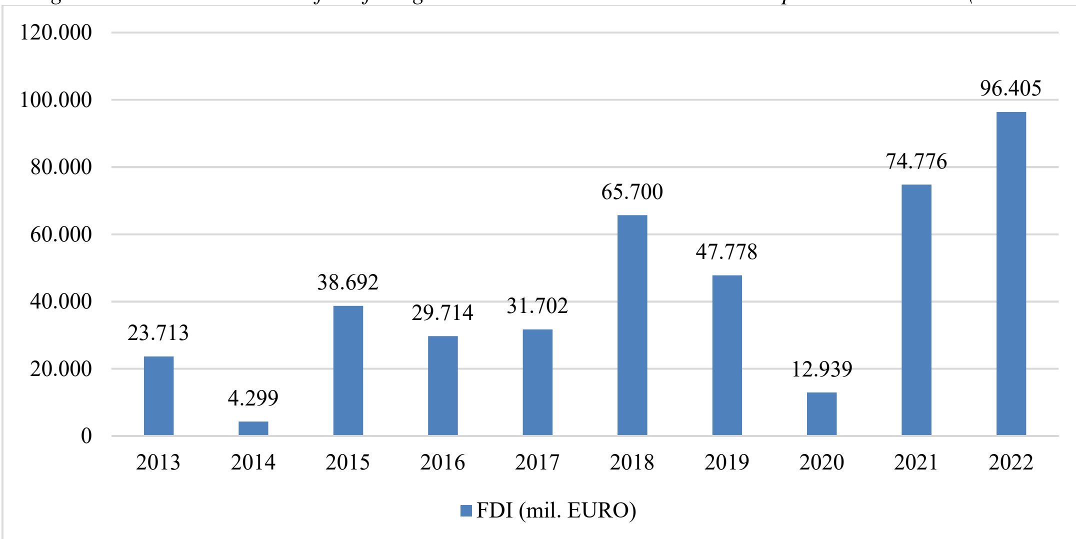
According to Figure no.1., the evolution of corporate tax collected at the state budget in France during the period 2013-2022 was an upward one. In the period 2013-2018, when corporate tax was 33.3%, the corporate tax collected increased from 49.536 mil. EURO in 2013 to 55.125 mil. EURO in 2018, respectively an increase of 11,28%.

In the period 2019-2022, when the level of the corporate tax rate began to decrease from 31% in 2019 to 25% in 2022, corporate tax collected began to increase from 59.277 mil. EURO in 2019 to 74.361 mil. EURO in the year 2022, representing an increase of 25,45%.

Therefore, it is found that the decrease of the tax could be one of the causes of the collection of a larger number of taxes to the state budget.

Regarding foreign direct investment inflows in France, we have collected the data and centralized it in another graph as follows:

Figure no. 2. The evolution of the foreign direct investment in France in the period 2013-2022 (mil. EURO)



Source: The World Bank, World Development Indicators

According to Figure no.2., inflows of foreign direct investments in France in the period 2013-2022 had an upward evolution but with significant corrections in certain years. In the period 2013-2017, when France practiced a corporate tax rate of 33,3%, foreign direct investments increased from 23.713 mil. EURO in 2013 to 31.702 mil. EURO in 2017, an increase of 33.69%.

It is interesting that one year before the tax reduction from 33,3% to 31%, respectively in 2018, FDI increased to 65.700 mil. EURO, by 107.24% compared to 2017. Moreover, in 2022, when the corporate rate reached 25%, FDI increased to 96.405 mil. EURO.

5. Conclusions

Regarding the impact of tax avoidance in the European Union, looking from the perspective of France, a state that practices a higher tax rate, compared to Germany or other states in the EU bloc, it has been observed that a reduction in the tax rate, paradoxically, can be a reason for an increase in taxes collected at the state budget, probably due to the reduction of profit-shifting strategies or the entry of a larger number of companies into the market.

It was also observed that reducing the tax rate can generate more FDI, but their evolution can also be decreasing during a period.

Probably the most interesting aspect, in the case of a country that practices a high tax rate, is the fact that the evolution of FDI is favorable, with France registering in certain years of the period 2013-2022 a level of FDI that exceeds even the corporate tax collected at the state budget.

In this context, the impact of tax avoidance in the European Union would be important to look at from the perspective of foreign direct investment inflows, which could amortize it.

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