Comments on “Where Does Multinational Profit Go” by Langenmayr and Liu

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How does worldwide taxation affect profit shifting?

Under worldwide taxation, some portion of tax savings from shifting are (re)captured by home country treasury – not under territorial taxation.

- Differences muted if WW tax is deferred until repatriation

So could the move towards territorial taxation lead to greater base erosion in high-tax countries?

Langenmayr and Liu examine the impact on profits of UK MNCs of the move to territorial taxation in 2009

- Profit rates (Earnings/Total assets) in unconsolidated affiliate accounts from Amadeus, 2006-12
- Difference-in-difference estimator: compare affiliates of UK-resident MNCs and other MNCs around the reform
- Treatment effect is 0.019 for affiliates in low-tax countries
  - "a 50% increase in the profitability of the median firm"
  - No significant effect on high-tax affiliates
  - Not driven by profitability of parents
  - Larger effects (not significant) for MNCs with intangibles
- Convincing research design, credibly estimated, with visible treatment effects in the aggregate data

Comment 1: What about shifting from high tax affiliates?

- Paper look for effects of reform in low-tax host countries, considers effects in high-tax hosts as placebo tests
- But with cross-crediting, shifting incentives depend on whether MNC is excess or deficient credit (Hines and Rice, 1994)
  - So reform should affect shifting by (some) high-tax affiliates
  - Magnitude depends on deferral – cf. Markle (2016)
- This matters for policy:
  - Spillover effects of reform on revenues of high-tax hosts – and implications for tax competition
- Paper doesn't discuss this
  - How did cross-crediting operate in UK before 2009?
  - Can you distinguish effects on excess credit/deficient credit firms – instead of high-tax/low-tax affiliates?

Comment 2: What about tax havens?

- Low tax countries here are not tax havens – they are middle tax countries
  - e.g. Austria is low-tax, Germany is high-tax
- Major profit shifting channel is to "true" tax havens – absent from the Amadeus data
- Given cross-crediting, we might expect that the move to territorial would increase profit shifting out of <u>all</u> EU affiliates – the spillover effect
- Langenmayr and Liu find the opposite – which makes these results especially interesting

Comment 3: This effect seems large! Is it a causal effect?

1) Should assets be on the RHS, not LHS?
   - End of deferral released trapped equity in affiliates
   - Should increase average profit rates, even without profit shifting?
2) Should host tax rates be on the RHS?
   - Heterogeneous treatment effect – larger for low-tax hosts?
   - Are magnitudes plausible? It helps to scale by predicted tax savings (which seem small here)
3) Is there balancedness of treatment and control?
   - Control group might be quite different – and affected differently by 2009-10 macro shocks
   - Robustness to country-year and industry-year FEs is reassuring
   - What about firm size, age, etc.?