Tax Planning by European Banks

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ABSTRACT Corporate tax base erosion due to profit shifting is a large and consequential problem that may cause lower governments spending, budget deficits and new forms of indirect or direct taxes to compensate the diminishing corporate tax revenues. In this context, it is important to assess profit shifting in order to better tackle it. To start with, estimating the size of the profit shifting is of a great deal. Quantifying profit shifting gives an idea about the money escaping the tax system. It is as well of a great consequence to check which countries are benefiting from profit shifting and which countries are suffering from its drawbacks. This can give more clarity on the direction of profit shifting among countries which will help in the identification of the loopholes in the text laws. Big multinationals should also be assessed to check if some are more aggressive than some others in engaging in profit shifting.

The main challenge when it comes to assess profit shifting is the access to data. Many researchers use the corporate financial and balance-sheet micro-data from Orbis. It has been shown that these data suffer from many limitations because not all the profits are recorded (most of the profits in tax havens are missing). The data used in this paper do not suffer from these limitations as the banks has to report their activity in each country where they operate. As of 2014, the financial institutions in Europe started disclosing their activity on a country-by-country level, following an EU directive (*Directive 2013/36/EU)*. The disclosures include the net banking income, the profits or losses before tax, the amount of taxes paid and the number of full-time employees. The data was hand collected and include the top 40 European banking groups and their affiliates between 2014 and 2017. This novel data permits to answer some very important questions: Do banks choose to have affiliates in low tax locations? If all countries had the same corporate tax rate: Which countries would gain or lose profits? What are the tax revenue losses?

Two methodologies are considered in this paper to evaluate profit shifting by European banks. The first approach is used widely in the literature and consists of an indirect method to calculate the excess profits due to tax differentials among countries. The second approach is to compare the profitability of the foreign banks with the profitability of the local banks. The results show that the banks' profits are sensitive to the tax rate and suggest that banks lower their tax burden through their subsidiaries. Depending on the method used, profit shifting by the top European banks is about 14% of the profits booked abroad in 2017. The tax planning affects differently the home countries of these banks. The home country that seem to be losing the most is France, where 26% of profits booked abroad are from tax planning. The tax revenues of the home countries are therefore affected: a quarter of tax revenues is lost for the year 2017.