Tax Planning in Norwegian Multinational Companies: Is Leverage Sensitive to International Tax Differences?

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Among the strategies multinational companies use to minimize their overall tax burden is optimizing the capital structure in all the subsidiaries of the parent company. Previous studies have proven the use of this strategy in countries such as Germany and the US, however the extent in Norwegian multinationals is uncertain. This study replicates the theoretical model of Huizinga (2008) and Møen et al (2011), exploring the effect by a multilateral approach to companies' debt shifting strategies.

Tax avoidance through optimizing capital structure in multinational companies is known as debt shifting. Companies that finance themselves with debt have a benefit compared to unlevered companies. The rental cost of debt, unlike the rental cost of equity, is tax deductible. This means that companies can use debt to reduce its tax burden. Multinational companies can take advantage of this opportunity to a greater extent than strictly domestic companies. They have the ability to shift debt across entities in the corporate group, exploiting the tax differences facing the group in the countries in which they operate. By stacking up debt in high tax countries, while leverage is kept low in low tax countries, the multinational companies can maximize what is known as the tax shield.

Debt shifting to a full extent does not only imply companies taking advantage of the domestic tax shield, but also exploitation of the global tax shield accessible to the group. The theory is that the mother company decides on the optimal capital structure considering all the subsidiaries in the group. This involves higher leverage in larger highly taxed subsidiaries on the expense of smaller subsidiaries in low tax countries. Capital structure in all subsidiaries is thus determined by the size of its assets and the tax rate in the country in which it operates. According to theory, the setup is completed by setting up an internal bank providing the subsidiaries with internal debt. This is located in the lowest taxed subsidiary to ensure the internal interest to be taxed at a lower rate than at which it is deducted.

I have explored the capital structure of Norwegian multinationals using financial data from Orbis – a global database of unconsolidated company information. Do these multinational companies consider the tax rates they face when deciding on a global optimal capital structure? As tax sensitivity in Norwegian multinationals is a topic where not much research has been conducted, my aim has been to reveal the driving factors in the allocation of debt in these groups.

Interestingly, the theoretical predictions do not hold when applied to Norwegian data. However, the lack of transparency between jurisdictions, complicated corporate structures and the absence of legislation such as country by country reporting cause incomplete financial statements in multinationals. Because the model I have estimated is based on a subsidiary's weighted share of a group's total assets, the large and complicated multinational groups are omitted. The sample used in the estimations therefore consists of rather small companies, only present in a few countries.

Among the companies in the final dataset, there is no indication of debt shifting for tax saving purposes. Hence, I find no sign of Norwegian multinational groups being aggressive tax planners. This can be due to the limitations on the sample. One should therefore not make definite conclusions on Norwegian multinationals as a whole based on this. In particular, it is possible that large companies use debt shifting strategies even if the small and medium sized companies in my sample do not.