Worldwide and Territorial Taxation and Multinational Firms' Competitiveness

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Abstract:

This study examines whether a worldwide tax regime impairs the competitiveness of subsidiaries of multinational groups (MNE) in foreign markets. Based on the assumption of product competition on a country-industry level and employing a DiD strategy which exploits the UK regime change from worldwide to territorial taxation in 2009, we find that sales of non-UK MNE affiliates (and thus of UK MNE affiliates' competitors) decreased in markets with a high share of UK MNE affiliates in high tax but not in low tax countries. We suggest that the driving force behind this surprising results lies in the distortion of the location decision of production under a worldwide tax regime. Since MNEs that are subject to a worldwide tax regime cannot benefit from lower tax rates in low tax countries, they are more likely to produce in the country in which the final product is also sold. The introduction of a territorial tax regime triggers thus the re-location of production for high tax countries towards low tax countries. We present several pieces of evidence in favour of this explanation. First, UK MNEs were more likely to set up subsidiaries in low tax countries and less likely to set up subsidiaries in high tax countries compared to other MNEs after the regime change. Second, investment and employment of UK MNE affiliates in high tax countries are unchanged after the regime change but output and material costs increase. Third, exports from low tax to high tax countries and imports of high tax countries from low tax countries increased in industries with a high share of UK MNE affiliates. We conclude that a worldwide tax regime decreases MNE affiliates' market shares in foreign high tax countries.