Abstract

Amid growing globalization, many countries have offered significant tax incentives to attract corporate investment. Recently, the E.U. began investigations involving tax ruling practices of several member countries in response to allegations that certain firms received favorable tax treatment ("state aid cases"). We use this state aid setting to study the nature, extent, and economic consequences of supergovernment tax enforcement.

We first examine E.U. scrutiny of U.S. firms by identifying the E.U.’s acquisition of publicly available financial statement information from the SEC’s EDGAR database. We show the E.U.’s scrutiny of U.S. firms is not limited to the four prominent U.S. firms targeted in formal state aid investigations. We find that E.U. attention is associated with disclosures of activity in the countries targeted by the state aid investigations.

We also document a substantial decline in U.S. investment to these countries in the years following state aid tax investigations relative to other E.U. member countries. Our results highlight potentially significant real effects of supergovernment tax enforcement and illustrate the likely reason why the individual countries providing the favorable tax treatment side with the firms and contest the rulings.