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### Where's the harm in tax competition? Lessons from US multinationals in Ireland

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#### Abstract

The term "harmful tax competition" has become endemic. It is taken as a tautology that competition among nations for the favors of multinational companies, using their tax systems as bait, is harmful. This is a view held even by those who believe competition to be an inherently good thing in most other areas of business. However, the nature of the harm is rarely analyzed, nor are the parties most harmed identified. This paper attempts to redress the balance. Using the case of technology-based US multinationals located in Ireland, it analyses the benefits and hazards to major stakeholders of tax rules that encourage multinationals to locate part of their operation offshore.

I argue that tax competition, even that not considered harmful by the OECD, can damage not only the home country of the emigrating multinational, but also the host country gaining the investment, local communities and the environment.

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#### 1. Introduction

Shackelford and Shevlin (2001), in a comprehensive review of empirical tax research in accounting, reduced the literature so far to three questions: Do taxes matter? If not, why not? If so, how much?

The first question is critical. If taxes do not matter, then any tax competition between nations for the attention of multinational companies is irrelevant and potentially harmless.

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This issue has mainly been addressed in previous studies by exploring the idea of tax neutrality—the design of a tax system that will not affect taxpayers' choices. Arguably, though, it should go further. In a non-neutral system, one designed to encourage taxpayers to take certain actions there is always the possibility that taxpayers will not respond as expected to incentives. Even where the tax system is neutral, the presence of taxation may in itself influence behavior in some way. There is, for example, anecdotal evidence that many taxpayers prefer to pay fees to tax advisors than taxes to government.

If taxes do influence the location choice of multinationals, then the third question becomes important. How much do the tax policies matter, for the economies concerned, and the major stakeholders of the business, employees, local communities, shareholders and governments in home and host countries? Do the home and host countries' tax systems interact to produce a range of incentives, planned or unintended? Are these policies coordinated, or are there rogue tax states producing policies perceived to be in their own best interest, at the expense of more civic-minded, less competitive nations? Is there, in fact, harmful tax competition?

And if there is tax competition of some sort between countries, whom does it harm? Are there benefits as well as hazards for stakeholders in a world where multinational businesses can move freely from one jurisdiction to another? What impact does this mobility have on those connected to the companies concerned? What, in short, are the policy implications?

Research into these questions feeds into a number of debates. Answers are essential for future policy decisions, Rawlings (2005) makes the case that for effective multilateral policies to be developed, it is important to establish whether tax competition exacerbates or curtails the inequalities of globalization. Tax competition also speaks to the wider issues of social conflict, as defined by Tinker and Neimark (1987) to include struggle between nations for drivers of economic success. War on Want (2003) considers research on the relative benefits and hazards of engaging in tax competition to be essential in tackling world poverty.

The paper uses the case of US investment in Ireland, in technology-based industry, to throw light on the relationships between the actors affected by tax competition. The choice was a considered one for two main reasons. Ireland is arguably one of the most successful of the tax competing nations, and technology is a clean, high-tech industry with few attending environmental problems. Ireland and the US enjoy good diplomatic ties, the tax treaty between the two countries is uncontested, and there are few issues of conflict between the two revenue services. As such, the case centres on perhaps the least contentious of all relationships between home and host country, the best possible set of circumstances for tax competition to be seen as a good thing for all concerned. Harmful effects that surface in this "best case scenario" are likely to generalize to less symbiotic relationships between home and host countries.

Secondly, where a multinational firm has subsidiaries overseas, the complex interaction of the tax systems of the home and host countries, perhaps channeled through a third jurisdiction to avail of a wider network of double tax treaties, is difficult, if not impossible, to model using publicly available company accounts data. However, the set of incentives placed on offer by a single jurisdiction, such as Ireland is easier to understand, particularly in relation to a single source of investment, such as the US.

The paper is structured as follows: first, the concept of tax neutrality is briefly explored, and the previous literature on impact of tax on the decisions of multinational

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