

INTERNATIONAL TAX REFORM AND THE IMPLICATIONS FOR MULTINATIONAL FINANCIAL MANAGEMENT

Haroldene F. Wunder *

Since 1986, a common trend in corporate income tax rates has emerged in the 14 countries studied in this research. On average, the highest corporate income tax rate in the 14 countries declined 11 percentage points, from 46.0 percent in 1985 to 35.0 percent in 1997. This convergence in rates should diminish the role of inter-country tax regimes in multinational corporations' (MNCs') repatriation decisions. However, significant inter-country differences still exist in tax holidays and in attitudes and policies toward foreign investment.

Multinational corporations (MNCs) possess a unique advantage: the ability to move funds and profits among various units through the use of internal financial transfer mechanisms, i.e., networks of financial linkages. These networks of financial linkages have value because of variations in national tax systems and in costs and barriers associated with international financial transfers.

Variations in national tax systems have historically played an important role in international financial management. For example, MNCs can engage in tax arbitrage and reduce their tax burden by shifting profits from units domiciled in high-tax countries to those in lower-tax countries. In the alternative, they may shift profits from business units in a taxpaying posture to those with tax losses.

Additionally, one of the most important uses of a judicious transfer pricing policy is to reduce taxes and tariffs, as well as to avoid exchange controls. Also, the decision to invoice an international transaction in one currency rather than another is affected by the relative tax rates in the foreign countries involved.

*Haroldene F. Wunder is affiliated with California State University, Sacramento

Finally, and most importantly, the design of a global remittance policy is affected by the variation in international tax rates. A global remittance policy requires the following interrelated decisions (Shapiro, 1996):

1. How much money (if any) to remit;
2. When to remit;
3. Where to transmit funds; and
4. Which transfer method(s) to use.

Decision 3-Where to transmit funds-is largely determined by variations in international tax regimes. Although their relative importance has diminished, dividends are still the most important means of transferring funds from foreign affiliates to the parent company. Shapiro (1996, p. 439) estimates that dividends account for more than 50 percent of all remittances to U.S. firms.

Moffett and Davison's (1996, p. 5) data are consistent with that estimate. Their study indicates that in 1993 dividends represented approximately 56 percent of total repatriated funds; whereas in 1989 they represented 74 percent of repatriated funds. While dividends' role in repatriated funds has decreased, the roles of royalties and license fees, charges for services, and net interest received has become more prominent. Even though their relative importance has shifted, all types of repatriated funds should be sensitive to variations in international income tax rates. For example, repatriating earnings to the parent in the form of management fees is relatively more attractive than repatriation by dividend because some countries (e.g., Switzerland) permit a deduction for expenses paid to the home office (i.e., parent) (Scholes and Wolfson, 1992, p. 250).

Even though many countries, including the United States, permit MNCs tax credits for income taxes paid to foreign jurisdictions, the credit mechanism fails to make the MNC "whole" when the relevant foreign tax rate exceeds the U.S. tax rate. In this case, the MNC is in an "excess credit" situation because the credit against U.S. income taxes is limited to what the foreign income tax would have been if (the lower) U.S. rates applied.

The purpose of this research is to show that the relative role of variations in international income tax rates in *certain* aspects of international financial management is diminishing because of the convergence in international income tax rates that began in the mid-1980s. However, when combinations of tax regimes are considered [(e.g., income taxes, value-added taxes (VATs), capital gain taxes, tax holidays, and withholding-tax policies)], significant inter-country tax differences are found to still exist. Those differences continue to impact MNC's financial and locational decisions.

The next section consists of a discussion of the following topics: repatriation models, relative tax rates, magnitude and trends in income tax rates in 14 developed countries from 1985 to the present, and other factors that affect MNCs' financial decisions, i.e., general policies toward foreign investment, specific tax incentives offered to attract inbound investment, taxation of corporations' distributions to foreign parents, scope of corporate income tax, presence of significant indirect taxes, and taxation of capital gains. The combined effect of corporate tax income tax, value-added tax, capital gains tax rates, and tax concessions is also discussed, along with implications for future research. The final section provides the conclusions of the research.

DISCUSSION

Repatriation Models

The following discussion of repatriation models flows significantly from Moffett and Davison's (1996) work. Only the more salient elements of each model are discussed here; Moffett and Davison (1996) discuss each model in greater detail.

The early literature regarding repatriation of foreign earnings assumes that MNCs are profit maximizers and focus on transfer pricing mechanisms to accomplish their objective. That body of literature views MNCs as exploiting tax differentials through transfer pricing and dividend repatriation (Lintner, 1956).

Kopits (1972) distills these philosophies into a theory of dividend repatriation behavior that focuses on differentials in tax rates, and empirically tests the theory with 1962 data on United States MNCs. As hypothesized, he finds an inverse relation between U.S. corporate income tax rates and dividend repatriation.

Adler (1979) develops a U.S. multinational taxation model based on the assumption that the MNC's objective is to maximize consolidated worldwide after-tax cash flows, not profits. His model assumes tax effects not only from repatriations in the form of dividends, but also from royalty payments, intra-firm interest payments, and fees. He also addresses the consequences of U.S. MNCs being in an "excess credit" position when foreign corporate income tax rates exceed U.S. corporate income tax rates.

Mutti (1981) abandons the profit- and cash-flow maximization assumptions. Instead, he assumes that an MNC sets a target income from each foreign subsidiary and then allocates repatriated earnings among dividends, interest, and royalties in the most *tax efficient* way. His statistically significant nonparametric test results obtain with regard to both profit rates and total repatriations relative to earnings. His results suggest that other flows are also responsive to tax incentives (Mutti, 1981, p. 247).

In contrast, survey studies by Zenoff (1968) and Robbins and Stobaugh (1973) find that few MNCs manage by focusing on worldwide profit- or cash-flow maximization. Those studies conclude that most parent corporations allow their affiliates to retain enough cash to meet their fund requirements and require them to repatriate the rest.

Relative Tax Rates

Tanzi (1987) studies tax reform, beginning in 1986, in 14 different countries¹ to discern if the 1986 U.S. tax reform was the impetus for tax reform initiatives elsewhere. He hypothesizes that the U.S. tax movement in 1986 may have "provided the officials of other countries with both a challenge and an opportunity to introduce changes in their own tax systems" (Tanzi, 1987, p. 339).

Instead, Tanzi concludes that tax reforms in both the United States and other countries in the mid-1980s were "political responses to accumulating evidence on the effects of tax systems on the economy" (1987, p. 339). Furthermore, he observes that "rarely has there been such a convergence of views on at least some of the aspects of the tax system that needed to be modified" (Tanzi, 1987, p. 339).

In other words, Tanzi found that, as of 1986, tax rates and tax regimes across countries were becoming more similar as a result of essentially contemporaneous tax reform initiatives. Grubert, Randolph and Rousslang (1996) agree that foreign tax reform

occurred concurrently with, and not as responses to, U.S. tax reform in the mid-1980s. The initiatives occurred because of various countries' assessments that existing tax systems negatively affected their economies and were increasingly viewed as unfair (Tanzi, 1987, p. 339). Furthermore, the tax reform initiatives in the mid-1980s were similar across countries in that they were characterized by the lowering of tax rates and the broadening of the tax base (Slemrod, 1990; Whalley, 1990).

Tanzi's comprehensive study appears only one year after the U.S.'s Tax Reform Act of 1986. He, therefore, lacks a lengthy vantage point. In contrast, this article benefits from a 12-year retrospective vantage point and examines the 1985-97 corporate tax rates of 14 countries whose corporate rates Tanzi studied. This time period provides sufficient comparative data to demonstrate that the cross-country tax reform momentum set in motion in the mid-1980s continues to the latter-1990s. In other words, the study period is of sufficient length to establish the existence of a pattern of converging corporate income tax rates. Value added tax (VAT) data are also provided because the post-1986 trend is to finance lower income tax rates with indirect taxes, e.g., VATs.

Magnitudes and Trends in International Corporate Income Tax Rates

The data in Table 1 show that from 1985 to 1997 all 14 countries studied by Tanzi (1987) reduced their highest corporate income tax rate significantly. Until 1997, Italy was an outlier, *raising* its highest corporate rate from 46.37 percent in 1985 to 53.2 percent. In 1997, however, Italy followed suit and reduced the top corporate rate to 37.0 percent, a rate in line with the other countries studied.

The average corporate rate across the 14 countries dropped from 46.0 percent in 1985 to 35.0 percent in 1997. The most prominent rate decrease occurred in Sweden, which reduced its corporate rate from 52.0 percent in 1985 to 28.0 percent in 1997, a 24.0 percentage-point decrease! The smallest decrease in the top corporate rate occurred in Japan, where the rate decreased 5.8 percentage points, from 43.3 percent in 1985 to 37.5 percent in 1997.

Table 1 also demonstrates how similar the corporate income tax rates are in the 14 countries. Ten of the countries' corporate rates cluster around low- to mid-30 percent. The lowest top rates are 28.0 percent (Finland and Sweden), while the highest rates are 45.0 percent (Germany and Ireland).

Clearly, the role of differential income tax rates in corporate repatriation decisions is diminished by the convergence of rates across countries that has occurred in the last ten years. However, Germany is unique in that, even though its corporate income tax rates have declined from 1985 to 1997, it taxes undistributed earnings more heavily than distributed earnings. The tax rate on distributed earnings was 36.0 percent in 1985 and declined to 30.0 percent in 1997. In contrast, undistributed earnings were subject to a 56.0 percent rate in 1985 and to a 45.0 percent rate in 1997. The discrepancy between rates applied to distributed and undistributed earnings makes repatriation of earnings from German affiliates relatively more attractive.

Other Factors Affecting Multinational Decisions

Although repatriation decisions should be less sensitive to inter-country income tax rates because of the effect of post-1986 international tax reform, one should not conclude that differences in international tax regimes are no longer important in multinational decisions. MNCs are also affected by, at least, the following factors:

- General policies toward foreign investment
- Specific tax incentives offered to attract inbound investment
- Taxation of corporations' distributions to foreign parents
- Scope of corporate income tax
- Presence of significant indirect taxes (e.g., VATs)
- Taxation of capital gains

Each factor is addressed below as it pertains to the 14 countries studied.

General Policies Toward Foreign Investment

Table 2 describes the 14 countries' general policies toward foreign investment. None of the 14 countries restrict the repatriation of capital or dividends. In fact, Canada, Ireland and Sweden actively encourage inbound foreign investment. The remaining countries strive for systems that are neutral toward foreign investment. Therefore, little inter-country variation exists in terms of general policies toward foreign investment since all are either neutral to or supportive of inbound investment.

Specific Tax Incentives Offered to Attract Foreign Investment

The tax hospitality with which new foreign investment is greeted varies considerably across countries. For example, Ireland's tax holiday posture stands out in the data presented in Table 3.

The Republic of Ireland has put in place generous tax concessions to attract inbound foreign investment. Most notable is the 10 percent tax rate applied until December 31, 2010 to profits from new investments in manufacturing (consisting of 18 industries), computer services, engineering, research and development, and certain financial services. Scholes and Wolfson (1992, p.258-9) provide additional commentary on Irish tax concessions, particularly as they pertain to international financial service centers (IFSCs).

Table 3 reveals that Australia, France, and Japan also offer significant *general* tax incentives to foreign investment. Canada, Denmark, France, Japan, and the United States offer substantial *regional* tax incentives to inbound investment. In addition, various countries (e.g., Australia, Canada, Finland, Ireland, Japan, the Netherlands, and New Zealand) offer additional tax concessions to foreign investment in certain industries, particularly those that engage in research and development.

Table I
Corporate Income Tax Rates

COUNTRY	1985	1986	1987	1988	1989	1990	1991	1992	1993	1994	1995	1996	1997	% Point increase (decrease) '85 - '97
Australia	46.0	46.0	46.0	49.0	39.0	39.0	39.0	39.0	39.0	33.0	33.0	36.0	36.0	(10.0)
Canada*	46.0	46.0	45.0	39.0	38.0	38.0	38.0	38.0	38.0	38.0	38.0	38.0	38.0	(8.0)
Denmark	40.0	50.0	50.0	50.0	50.0	50.0	34.0	38.0	34.0	34.0	34.0	34.0	34.0	(6.0)
Finland	43.0	33.0	33.0	33.0	33.0	25.0	23.0	19.0	25.0	25.0	25.0	28.0	28.0	(15.0)
France														
Distributed Earnings	50.0	45.0	45.0	42.0	42.0	42.0	42.0	34.0	33.3	33.3	33.3	33.3	33.3	(16.7)
Undistributed Earnings	50.0	45.0	45.0	42.0	39.0	37.0	34.0	34.0	33.3	33.3	33.3	33.3	33.3	(16.7)
Germany														
Distributed Earnings	36.0	36.0	36.0	36.0	36.0	36.0	36.0	36.0	36.0	30.0	30.0	30.0	30.0	(6.0)
Undistributed Earnings	56.0	56.0	56.0	56.0	56.0	50.0	50.0	50.0	50.0	45.0	45.0	45.0	45.0	(11.0)
Ireland	50.0	50.0	50.0	47.0	43.0	43.0	40.0	40.0	40.0	40.0	38.0	38.0	36.0	(14.0)
Italy	46.37	46.37	46.37	46.37	46.37	46.37	47.83	52.2	52.2	52.2	53.2	53.2	37.0	(9.37)
Japan	43.3	43.3	42.0	42.0	40.0	40.0	37.5	37.5	37.5	37.5	37.5	37.5	37.5	(5.8)
Netherlands	42.0	42.0	42.0	42.0	40.0	40.0	40.0	40.0	40.0	40.0	40.0	40.0	36.0	(6.0)
New Zealand	45.0	45.0	48.0	48.0	28.0	33.0	33.0	33.0	33.0	33.0	33.0	33.0	33.0	(12.0)
Sweden	52.0	52.0	52.0	52.0	52.0	30.0	30.0	30.0	30.0	28.0	28.0	28.0	28.0	(24.0)
United Kingdom	40.0	35.0	35.0	35.0	35.0	35.0	34.0	33.0	33.0	33.0	33.0	33.0	31.0	(9.0)
United States	46.0	46.0	40.0	34.0	34.0	34.0	34.0	34.0	35.0	35.0	35.0	35.0	35.0	(11.0)
Average	46.0	45.0	45.0	43.0	41.0	39.0	37.0	37.0	37.0	36.0	36.0	36.0	35.0	(11.0)

*Canada: Rates are not reduced by the 10% provincial abatement and do not include surtax.

Sources: Offices of Deloitte & Touche and Ernst & Young; in the various countries. Price Waterhouse World Firm Services, New York.

Table 2
Policies Toward Foreign Investment

COUNTRY	POLICIES TOWARD FOREIGN INVESTMENT
Australia	Government does not restrict the repatriation of capital or dividend payments on investments in Australia, thus contributing to Australia's reputation as a secure location for investments.
Canada	Canada imposes no foreign exchange controls and no other restrictions on the repatriation of profits or capital by foreign investors. The federal and provincial governments offer a wide range of tax and nontax incentives in the form of grants, loans, and guarantees.
Denmark	The government neither favors nor discriminates against inbound foreign investment. Foreign-owned enterprises are treated on an equal basis with local Danish companies.
Finland	There are no restrictions on the repatriation of capital or profits and labor costs. Except for certain tax incentives pertaining to development areas, the taxation policy emphasizes neutrality.
France	Both profits and capital may be repatriated. Tax concessions are available to both domestic and foreign investors.
Germany	There are no restrictions on the transfer of profits abroad or on repatriation of capital.
Ireland	Foreign investment is actively encouraged through tax incentives, cash grants, interest subsidies, loan guarantees, and equity finance. Repatriation of profits and capital is not restricted.
Italy	Capital and profits are freely remitted abroad. The industrial tax initiatives set up for Italian companies apply equally to foreign investors.
Japan	Repatriation is not restricted. The basic taxation system neither favors nor discriminates against inbound foreign investment.
Netherlands	There are no restrictions on repatriation. The tax system is neutral toward foreign investors.
New Zealand	Generally, the government's policy is one of tax neutrality; most incentives have been removed. Repatriation is not restricted.
Sweden	Free movement of capital is preserved. There is a generous and open attitude toward foreign investment.
United Kingdom	Repatriation is not restricted. Generally, the UK tax system is neutral towards foreign investment.
United States	The government attempts to remain neutral regarding tax treatment of foreign and domestic capital investment.

Source: Doing Business in . . . Series. New York: Price Waterhouse World Firm Services.

Table 3
Tax Incentives For Inbound Foreign Investment

COUNTRY	TAX INCENTIVES
Australia	1. A tax depreciation allowance on buildings designed to encourage construction activity. 2. Pooled Development Funds (PDFs) to facilitate investment in high technology, small- and medium- size enterprises. 3. Tax deduction of 150 percent for expenditures by companies, including subsidiaries of foreign-owned parents, for research and development (broadly defined) carried on in Australia. 4. Exemption from Australian withholding tax for interest paid by offshore banking unit (OBU) on certain offshore borrowings. Concessional 10 percent tax rate applies to profits derived by authorized OBUs. 5. Deductibility of certain costs of establishing a regional headquarters (RHQ) in Australia, even if the costs do not meet the standard criteria for deductibility. Exemption from sales tax on certain imported computer equipment and related equipment for use in such RHQs.
Canada	Regional Incentives: Investment tax credit to encourage investment by certain taxpayers in certain activities and specific regions. The credit rate varies from 10 to 35 percent, according to taxpayer, activity, region, and year involved. Other Credits: Credits for carrying on manufacturing and processing activities, the result of which is to lower the corporate tax rate by 7 percent. Industry Incentives: One of the most favorable packages of research and development tax incentives. Both current and capital expenditures incurred in Canada on scientific research activities are specifically allowed as a deduction in the year incurred (except for buildings acquired after 1987). Film Industry: Beginning in 1995, a 12 percent, fully refundable tax credit (i.e., the Canadian Film or Video Production Tax Credit) for corporations that produce eligible films or videos. Also, a 30 percent depreciation rate for Canadian film or video productions, which is deductible against nonfilm income. Earnings: Earnings can be freely repatriated to a nonresident parent or

COUNTRY	TAX INCENTIVES
	reinvested in Canada unless the terms of an incentive received by the corporation contains restrictions.
Denmark	General Incentives: No special tax concessions to encourage foreign businesses to locate in Denmark, but no special taxes on the repatriation of earnings. Regional Incentives: Tax deductions on fixed assets and buildings at twice the normal percentages in specific trade zones. Industry Incentives: No special industrial tax incentives, but deduction of 125 percent of expenditures on research and development allowed.
Finland	General Incentives: No general tax concessions aimed specifically at attracting foreign business to Finland. Specific Incentives: 1. Tax rules designed to attract foreign loan capital to Finnish borrowers (i.e., Finnish bonds, debentures and loans from abroad are exempt from Finnish net worth tax). 2. In developed areas, free depreciation (i.e., no limitation on percentage) applies to new investment in production facilities (excluding land) or in tourism for the first ten years after the investment is put into use.
France	General Incentives: 1. Tax holidays available for new companies investing in one of the three enterprise zones. 2. Tax credits available for companies created in the two privileged investment zones in the north of France. 3. In other regions, partial or total exemption from local business tax for up to five years, a reduction in registration taxes, and accelerated depreciation on new construction. Regional Incentives: 1. Tax holidays of up to 10 years in the three enterprise zones. 2. Tax credits for industrial investment in the privileged investment zones. 3. Exemption from local business taxes, reduced transfer taxes, accelerated depreciation, and duty-free imports in the two free-trade zones.
Germany	General Incentives: Tax concessions are basically in the form of additional or accelerated depreciation. (For accounting purposes, claiming accelerated depreciation has the effect of creating an untaxed reserve that cannot be distributed. The higher 45 percent rate applies to

COUNTRY	TAX INCENTIVES
	undistributed earnings.) Accelerated depreciation is 40 percent of cost of capital investment through 1998.
Ireland	General Incentives: 1. Major tax incentive is a corporate tax rate of 10 percent for manufacturing, computer services, engineering, R&D, and certain financial services on profits earned between January 1, 1981 and December 31, 2010. (Eighteen industries are classified as "manufacturing.") 2. Certain tax treaties contain tax-sparing clauses, allowing parent companies a reduced corporate tax rate in Ireland when profits are remitted from an Irish corporation. 3. Certain financial services carried out in specific areas qualify for a reduced corporate tax rate until December 31, 2005. 4. Although in general the availability of accelerated depreciation has been curtailed, in some cases 100 percent depreciation is still allowed (e.g., on machinery and equipment in the Dublin International Financial Services Center). 5. Companies that mine for certain minerals are entitled to an immediate write-off of the cost of machinery and equipment, exploration, and development. In addition, they may claim an investment allowance of 20 percent of the cost machinery and equipment and of exploration. 6. An organization setting up an "administrative headquarters" in Ireland may negotiate tax rates with the Irish Revenue authorities.
Italy	General Incentives: Tax concessions are limited to the southern regions: 1. A 100% tax holiday from corporate income tax (IRPEG) for ten years after incorporation. 2. Exemption from local income tax (ILOR) for profits reinvested.
Japan	General Incentives: Tax privileges available to corporations that are permitted to use the "blue form" tax return: 1. Tax loss carrybacks and carryforwards. 2. Credits for qualifying expenditures 3. Special allowances for overseas transactions. Regional and Local Incentives: Preferential tax rates offered to attract specific industries and businesses.
Netherlands	General Incentives: 1. No tax holidays. 2. Recent general tax rate reductions have led to reduction in other investment incentives. 3. However, the government has introduced fiscal incentives to

COUNTRY	TAX INCENTIVES
	stimulate R&D activities (through reduction of taxes on wages of employees engaged in approved R&D activities).
New Zealand	General Incentives: Virtually none. Industry Incentives: 1. Current deductibility of mining exploration costs. 2. Limited encouragement of agriculture, forestry, and mining in the form of capital expenditure deductibility in year incurred.
Sweden	General Incentives: No special tax concessions. However, the following attributes encourage inbound foreign investment: 1. Relatively low corporate tax rate (28%). 2. Effective tax treaty network allowing repatriation of earnings with no or very low withholding tax. 3. Accelerated depreciation on fixed assets or building untaxed reserves on the basis of current-year profits.
United Kingdom	General Incentives: Few specific tax incentives for inbound foreign investment. However, the following factors are advantageous: 1. Relatively low corporate tax rate (31 percent). 2. Extensive network of double tax treaties. 3. Deductibility of both capital and current expenditures on scientific research.
United States	General Incentives: 1. Generous accelerated depreciation rates. 2. Deductibility of wide range of business expenses. 3. Net operating loss carrybacks and carryforwards. 4. Extensive incentives for mineral properties. State and Local Incentives: 1. Property tax exemptions or reductions for new industry. 2. Negotiated underassessment of industrial property. 3. Assistance with tax-exempt bond financial (available in all states except Hawaii, Idaho, and Washington).

Source: Doing Business in . . . Series. New York: Price Waterhouse World Firm Services.

Following is a list of the types of tax incentives offered and the countries in which they are applicable:

General, Regional, and Industry-Specific Incentives: Japan

General and Regional Incentives: France

General and Industry-Specific Incentives: Australia, Ireland

Regional and Industry-Specific Incentives: Canada

Regional Incentives: Denmark, United States

Industry-Specific Incentives: Finland, Netherlands, New Zealand

The types of incentives provided are probably attributable to country-specific characteristics. For example, Canada's organization as a federation of provinces likely accounts for its extensive regional tax incentives.

Taxation of Corporations' Distributions to Foreign Parents

Eleven of the 14 countries subject corporations' distributions to their foreign parent corporations to withholding tax. Table 4 describes each country's withholding regime.

Table 4
Taxation Of Foreign Corporations' Distributions

COUNTRY	TAXATION OF FOREIGN CORPORATIONS
Australia	A company incorporated outside Australia is not a resident of Australia unless it carries on business in Australia and either its central management and control is in Australia or its voting power is controlled by residents of Australia. Nonresident foreign corporations are taxed on Australian-source income but are exempt from tax on income derived from sources outside Australia. Dividends paid by an Australian company to a foreign corporation are exempt from withholding if they are franked. Other dividends are subject to withholding tax (e.g., 15% rate if paid to a U.S. corporation).
Canada	A corporation is generally considered nonresident for Canadian tax purposes if it is incorporated outside Canada and its central management and control reside outside Canada. Nonresident corporations are subject to Canadian income tax in respect of income derived from carrying on business in Canada and capital gains from the disposition of taxable Canadian property. Dividends paid by Canadian subsidiaries to nonresident parent corporations are subject to nonresident withholding taxes (generally 10 or 15 percent to treaty countries).
Denmark	In general, treaties limit the taxation of industrial and commercial activities in Denmark to the profits attributable to a permanent establishment in the country. Dividends paid to a foreign corporation are subject to withholding tax at a 30%, or lower tax treaty, rate.
Finland	A nonresident company having a permanent establishment in Finland is subject to Finnish taxes on the income earned through the Finnish permanent establishment. Dividends paid to nonresident shareholders, excluding stock dividends, are subject to a withholding tax of 25 percent if there is no applicable tax treaty rate.
France	Nonresident foreign corporations are subject to corporate income tax if they are engaged in a trade or business in France. Dividends paid to foreign shareholders are subject to a 25 percent withholding tax or a reduced tax treaty rate (e.g., 5 percent if paid to a

COUNTRY	TAXATION OF FOREIGN CORPORATIONS
	U.S. parent).
Germany	A foreign corporation is considered a limited taxpayer in Germany and is taxable by reference to its German-source income only. Dividends paid by German subsidiaries to parent corporations are subject to a withholding rate of 25 percent or reduced treaty rate (e.g., 5% if paid to a U.S. parent).
Ireland	No withholding tax is levied on dividends paid to nonresidents. Dividends issued to a parent resident in a treaty country are not subject to advance corporation tax (ACT) if the parent satisfies certain equity ownership requirements.
Italy	In general, treaties limit the taxation of business activities to profits attributable to a permanent establishment in Italy. Dividends paid to a foreign corporation are subject to various withholding tax rates. (The applicable rate for dividends paid to U.S. parents is 5 percent.)
Japan	Dividends paid to a foreign corporation are generally subject to Japanese withholding at a 20% or lower treaty rate.
Netherlands	Dividends are generally subject to a 25 percent withholding rate unless reduced (frequently substantially) under a Dutch tax treaty.
New Zealand	Dividends are subject to withholding tax on the same basis as that which applies to foreign shareholders generally, i.e. 15 percent for most treaty countries, 30 percent otherwise.
Sweden	Dividends from subsidiaries to foreign parent companies are subject to a 30 percent, or lower treaty, withholding tax rate.
United Kingdom	Dividends: The United Kingdom does not impose a withholding tax on the distribution of profits.
United States	Generally, U.S.-source dividends received by a foreign corporation from its U.S. subsidiary are subject to a 30 percent, or lower treaty, withholding tax rate.

Source: Doing Business in . . . Series. New York: Price Waterhouse World Firm Services.

Only Australia, Ireland, and the United Kingdom lack a withholding requirement. The withholding rates in the other 11 countries range from five to 30 percent, with lower rates applied to distributions to parents in countries with which they have double taxation treaties.

Scope of Corporate Income Tax

The data in Table 5 confirm the similarity in the scope of the 14 countries' corporate income tax.

Table 5
Entities Exempt From The Corporate Income Tax

COUNTRY	EXEMPT ENTITIES
Australia	1. Municipal corporations and public authorities 2. Mutual and nonprofit organizations 3. Cooperative societies and companies 4. Funds established for public charities or public education activities 5. Registered trade unions 6. Employers' associations 7. Nonprofit societies for encouragement of music, art, science, or literature.
Canada	1. Government-controlled corporations 2. Charitable organizations 3. Nonprofit corporations 4. Mutual insurance corporations
Denmark	All entities except: public limited corporations, private limited companies, other entities with limited liability, and cooperative societies and associations.
Finland	1. State, municipal, and religious communities 2. Nonprofit organizations for education, science, arts, public defense, politics, and charity.
France	All entities except: corporations, LLCs, limited partnerships with shares, silent partners of limited partnerships, and permanent establishments of foreign head offices.
Germany	All entities except: all German corporations.
Ireland	1. Charities if profits are used for the purposes of the charity. 2. Approved bodies formed to promote athletic or amateur games or sports. 3. Credit unions.
Italy	All entities except: corporations, LLCs, incorporated partnerships, cooperatives, and mutual insurance companies with a legal or administrative headquarters or principal business purpose in Italy.
Japan	Public welfare corporations

COUNTRY	EXEMPT ENTITIES
Netherlands	1. Nonprofit public and private welfare organizations General social security funds
New Zealand	1. Charitable, educational, religious, or sporting associations 2. Nonprofit organizations 3. Associations formed for the mutual benefit of members
Sweden	Foreign legal entities earning royalties from Sweden (de facto exemption)
United Kingdom	All entities except "companies" (which includes any body corporate, whether incorporated in the UK or elsewhere, or unincorporated association, but does not include a partnership or local authority).
United States	1. Federal and related agencies 2. Religious, charitable, educational, scientific, literary, etc. organizations 3. Civic leagues and employee unions 4. Labor, agricultural, and horticultural organizations 5. Business leagues, chambers of commerce, real estate boards, etc. 6. Social clubs 7. Fraternal beneficiary societies 8. Voluntary employees' beneficiary associations 9. Local teachers' retirement fund associations 10. Local benefit life insurance associations, mutual or cooperative telephone companies, etc. 11. Cemetery companies 12. Credit unions 13. Mutual insurance companies 14. Farmers' cooperatives 15. Armed forces members' posts or organizations 16. Group legal service plans 17. Religious and apostolic organizations 18. Cooperative hospital service organizations 19. Cooperative service organization of educational institutions 20. Qualified state tuition programs

Source: Doing Business in . . . Series. New York: Price Waterhouse World Firm Services.

The majority of the countries exempt municipal and other public authorities, charities, and not-for-profit organizations. Therefore, the corporate income tax reaches similar economic segments of all countries studied.

Value-Added Taxes (VATs)

In Europe, the post-1986 trend has been to finance lower income tax rates by imposing or expanding indirect taxes, e.g., VATs. Table 6 contains data pertaining to standard VAT rates in the 14 countries.

Table 6
1997 Corporate Income And Value-Added Tax (Vat) Rates

<i>COUNTRY</i>	<i>PROFITS/INCOME TAX</i>	<i>VALUE/ADDED TAX</i>
Australia	36.00%	None
Canada	38.00%	None ¹
Denmark	34.00%	25.00%
Finland	28.00%	22.00%
France	33.33%	20.60%
Germany	30.00%/45.00%	15.00%
Ireland	36.00%	21.00%
Italy	37.00%	19.00%
Japan	37.50%	None
Netherlands	36.00%	17.50%
New Zealand	33.00%	None ²
Sweden	28.00%	25.00%
United Kingdom	31.00%	17.50%
United States	35.00%	None
Average	34.52%	20.29%

Source: Corporate Taxes: A Worldwide Summary, 1997 Edition, New York: Price Waterhouse World Firm Services BV, Inc.

Ten of the 14 countries have both a corporate income tax and a VAT. It is important to note that none of the ten countries replaced their corporate income tax with a VAT. Instead, VATs are used as a supplement to, and a means of financing, the lower corporate income tax rates.

Therefore, any conclusions drawn regarding the trend in decreasing corporate income tax rates must be tempered by the existence of VATs and the combined effect of the two tax regimes. The combined corporate income tax and value-added tax rates in the ten countries with both tax regimes range from 42.50 percent (Japan) to 60 percent (Germany).

Taxation of Capital Gains

Countries' capital gains tax regimes also affect the inter-country cost of doing business. The overwhelming majority of the 14 countries studied tax corporate capital gains at ordinary rates. Table 7 provides a concise explanation of the taxation of capital gains in each country. The data in Table 7 are further evidence of the growing similarity in corporate taxation across international boundaries. Few inter-country differences exist.

Combination of Tax Regime Effects

The combination of income tax, VAT, and capital gains tax regimes has the potential to cause significant differences in the total tax cost of multinational activities. For example, the combination of no preferential treatment of capital gains and the existence of VATs make Denmark, Germany, Italy, the Netherlands, Sweden, and the United Kingdom relatively undesirable business locations from a tax-cost perspective.

In addition, these six countries are not among those offering generous tax concessions to encourage foreign investment. Germany, Italy, Sweden, and the United Kingdom provide no specific tax concessions to foreign investment. Denmark and the Netherlands provide only regional and industry-specific incentives, respectively.

Although the Republic of Ireland offers an array of tax concessions and tax holidays to *new* foreign investment, its combined income and value-added tax rate is a sizable 57 percent. Furthermore, Ireland's standard corporate capital gains tax rate is 40 percent. Ireland's tax hospitality stems from general and industry-specific tax incentives, not from low income, value-added, or capital gains tax rates.

Table 7
Capital Gains Tax Regimes Corporations

COUNTRY	TAXATION OF CAPITAL GAINS
Australia	The capital gains tax applies to assets acquired on or after September 20, 1985. Capital gains are subject to tax at ordinary rates of tax. Capital losses are allowable as deductions only against capital gains and cannot be offset against other income .
Canada	Three-quarters of a capital gain is taxable, included in the corporation's income, and taxed at ordinary rates. Three-quarters capital losses are deductible, but only against capital gains. A three-year carryback and infinite carryforward provision exists.
Denmark	Capital gains and/or losses are included in ordinary taxable income. A capital gain on the sale of shares held for more than three years is tax exempt. Special rules apply to investment subsidiaries in a tax haven and to sales of real estate.
Finland	Capital gains and losses are generally included in taxable income. For example, sales proceeds are included in taxable income and the undepreciated tax basis of the asset sold is deducted in the year of sale.
France	Short-term capital gains (on assets held less than two years) are generally taxable as ordinary income. Long-term capital gains on depreciable assets are taxed at the reduced rate of 19% on the excess of sales price over original cost; however, depreciation is recaptured as short-term gain. Long-term capital gain on nondepreciable assets held for two or more years and on shares representing at least 10% interest in a company held for more than two years are treated as long-term capital gains.
Germany	Capital gains (and losses) are taxed as part of ordinary business income (or losses). Postponement of gain recognition on certain fixed assets is possible when the gain is offset against the cost of certain replacement items.
Ireland	Since April 6, 1992, a single rate of 40% applies to all capital gains. Capital losses can only be used as offsets to capital gains in the same year or carried forward indefinitely.
Italy	Capital gains are generally taxable in full in the tax period in which they are reported in the corporation's accounting records. Tax on the capital gain from the sale of fixed assets may be included in taxable income ratably over a period not exceeding five years. (Prior to 1989 the

COUNTRY	TAXATION OF CAPITAL GAINS								
	installment period was not to exceed ten years.) For periods ending December 31, 1993, and later, installment recognition is permitted only for gains from dispositions of fixed assets held for more than three years.								
Japan	Generally, capital gains or losses are treated as ordinary income or losses. However, capital gains on the transfer of land and the right to land located in Japan made on or after January 1, 1992 are subject to additional or separate taxation methods depending on the holding period, as follows: <table> <tr> <td><u>Holding period</u></td><td><u>Taxation</u></td></tr> <tr> <td>Two years or less</td><td>Separate taxation; standard corporation tax rate plus 30%.</td></tr> <tr> <td>Over two years but not more than five years</td><td>Regular corporation tax, plus additional tax of 20%</td></tr> <tr> <td>Over five years</td><td>Regular corporation tax, plus additional tax of 10%</td></tr> </table>	<u>Holding period</u>	<u>Taxation</u>	Two years or less	Separate taxation; standard corporation tax rate plus 30%.	Over two years but not more than five years	Regular corporation tax, plus additional tax of 20%	Over five years	Regular corporation tax, plus additional tax of 10%
<u>Holding period</u>	<u>Taxation</u>								
Two years or less	Separate taxation; standard corporation tax rate plus 30%.								
Over two years but not more than five years	Regular corporation tax, plus additional tax of 20%								
Over five years	Regular corporation tax, plus additional tax of 10%								
Netherlands	Generally capital gains are taxed as ordinary income. However, special rules apply to capital gains from dispositions of certain stock investments and depreciable property. Capital losses are generally deductible.								
New Zealand	There is no capital gains tax.								
Sweden	Capital gains and losses are generally taxed as ordinary income or loss. Capital losses on certain financial instruments (e.g., stock, stock options, and convertible debentures) are allowed only as an offset to capital gains on the same group of assets.								
United Kingdom	Capital gains are taxed at the regular corporation tax rate of 33%. Capital losses are allowed only as offsets to capital gains; however, excess capital losses may be carried forward without limitation.								
United States	After netting short- and long-term capital gains and losses, any net capital gain is included in gross income and taxed at the regular corporate tax rates. Capital losses are allowed only as offsets to capital gains. Excess capital losses may be carried back three years and carried forward five years to offset capital gains.								

Source: Corporate Taxes - A Worldwide Summary, 1997 Edition, Price Waterhouse World Firm Services.

Even though Japan has both corporate income and value-added taxes, the combined rate is a *relatively* moderate 42.50 percent. Combined with its general, regional, and industry-specific tax incentives, and its multi-level system for taxing capital gains from land sales (see Table 7 for details), Japan's tax climate is relatively welcoming to foreign investment.

It is evident from the foregoing data and discussion that a trend in any particular tax factor (e.g., corporate tax rates) must be analyzed in conjunction with numerous other factors to determine the effect on MNCs' financial decisions. Furthermore, not only general, but also regional, local, and industry, systems must be taken into account.

In addition, a country's income tax rate is a measure of tax cost. The societal benefits accruing from the imposition of any particular tax are also relevant, although beyond the scope of this particular research.

Implications for Future Research

The international tax rate data provided herein suggest that future empirical research is in order to determine the response of individual MNCs to the international convergence of corporate income tax rates over the past ten years, the corresponding imposition (or expansion) of VATs, and the variations in capital gain tax regimes. Such research should focus on both repatriation and locational decisions.

Furthermore, the January 1, 1999, adoption of the Euro as the national currency of participating member states of the European Union (EU) signals a movement toward even greater economic uniformity among the 15 EU countries, which should result in a continuation of convergence in income tax rates. Future research should study repatriation and location decisions from both retrospective (i.e., previous tax reform) and prospective (i.e., anticipated tax, and other economic, reform).

CONCLUSION

Since 1986, a trend in the corporate income tax has emerged in the 14 countries studied. On average, the highest corporate income tax rate in the 14 countries declined 11 percentage points, from 46.0 percent in 1985 to 35.0 percent in 1997. This convergence of corporate income tax rates should diminish the role of inter-country tax regimes in repatriation decisions involving dividends, royalties, license fees, charges for services and net interest received.

Other factors affecting MNCs' financial decisions were identified and discussed. For the most part, the 14 countries were similar in terms of general policies toward foreign investment, taxation of corporations' distributions to foreign parents, and the scope of the corporate income tax. Some differences exist in the tax holidays offered by the 14 countries, with the Republic of Ireland providing the most generous tax incentives for inbound investment.

In addition, European countries have responded to the decline in corporate income tax rates by imposing (or expanding) indirect taxes, e.g., VATs. Ten of the 14 countries have both corporate income and value-added tax regimes. Some inter-country variation also exists in the rates applied to capital gains. The combination of tax rates, tax holidays, and attitudes and policies toward converging international corporate income tax rates is apparent.

NOTES

1. Tanzi presents 1986 tax rates for: Australia, Canada, Denmark, Finland, France, Germany, Ireland, Italy, Japan, the Netherlands, Sweden, New Zealand, United Kingdom, and the United States.

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