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Mapping Tax Strategy on to a Model of Foreign Direct Investment: A Theoretical Perspective

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Aims and objectives

- To examine in detail the literature on the foreign direct investment (FDI) decision process undertaken by multinational enterprises (MNEs) with particular reference to the role of tax; to investigate and demonstrate the theoretical interface between tax strategy and corporate strategy.
- We consider:
 - tax issues apparent in practice
 - FDI as a form of corporate strategy with respect to overall business strategy
 - the FDI decision making process
 - how tax fits into the various stages of this decision process and analyse this...
 - ...and finally, offer our conclusions

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Tax issues raised in practice

- MNEs are so placed that can take advantage of the variation in taxes across different jurisdictions, so may be incentivised to consider tax strategy to a greater extent than small firms.
- Note the 2008 Tesco case, as reported in the *Guardian*. How is tax strategy linked with corporate strategy? Did tax considerations drive or were driven by strategic decisions here?
- No offence against UK law – but morality and CSR?
- Avoidance has same overall effect as evasion in lowering tax take, and may be achieved by 'financial engineering' and highly artificial schemes, e.g., 'Reverse Morris Trust'.

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Tax issues raised in practice (cont.)

Parent co. wishes to sell assets to a smaller external co.

Sets up subsidiary co. → Merge to form unrelated co.

Issues 50% of its shares to parent co. shareholders

Result = transfer of assets, tax free, to smaller external co.

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Tax issues raised in practice (cont.)

> Is there a clear dividing line between evasion and avoidance?

Lymer and Oats, 2010, p. 38

> What is 'acceptable' as opposed to 'unacceptable' avoidance? Where does a legal issue become a moral one?

> Accounting firms are major players in selling tax strategy and planning schemes.

> Henderson Global Investors 2005 survey – tension between managing tax and concept of CSR – but rules generally tightened.

FDI as corporate strategy

> FDI defined as “[i]nternational capital movement with the investing companies retaining the control over the use of the resources involved” (Qu and Green, 1997, p. 2).

> Establishing, acquiring or expanding an affiliated subsidiary/branch.

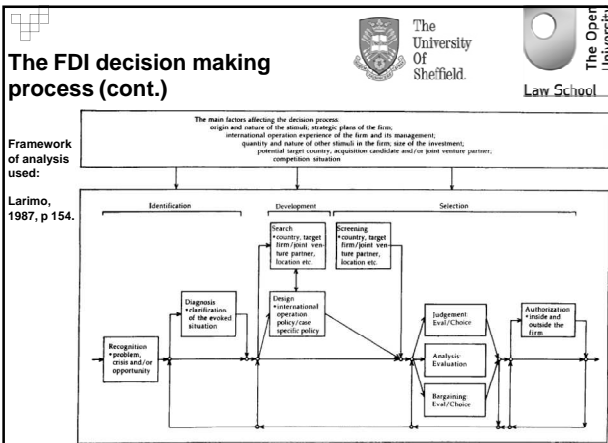
> New markets, marketing channels, cheaper production, access to new technology/products/skills/financing.

> MNEs involved.

> Hence cross-border transactions, possibly double taxation.

> Therefore nature of FDI provides an opportunity to understand tax in this decision making process and understand the interaction between tax strategy and corporate in this area.

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- The role of tax in the FDI decision process**
- Location decisions.
 - Strategic motives.
 - Choice of strategic market entry mode.
 - Selection of ownership form of FDI + financial structure.
 - Transfer pricing strategy.
 - Income shifting policy.
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The role of tax in the FDI decision process (cont.)

Stages of FDI decision process	FDI strategic decisions	Tax strategy applicable
Recognition and Diagnosis	<ul style="list-style-type: none"> • Location of FDI • Strategic motives for FDI 	<ul style="list-style-type: none"> • Tax rate differentials in different jurisdictions and/or per industry type • Favourable tax incentives offered in different host countries
Search, Design and Screening	<ul style="list-style-type: none"> • Strategic market entry mode • Ownership form of FDI 	<ul style="list-style-type: none"> • Tax rates applicable to different legal structures, e.g., public or private limited companies, partnerships, etc. • Tax benefits applicable to different organisational forms, e.g., JV, 'greenfield' site, M&A, subsidiary or branch
Evaluation choice (evaluating the feasibility, e.g., judgment, bargaining and analysis)	<ul style="list-style-type: none"> • Transfer pricing strategy • Income shifting policy • Profit repatriation 	<ul style="list-style-type: none"> • Arm's length price between related parties in cross-border transactions • Shifting income from high tax country to low tax country (if possible) • Timing of repatriation of dividends/profits from the foreign subsidiary
Authorization	<ul style="list-style-type: none"> • The stages at which tax issues are considered in the FDI decision process • Priority between tax strategy and corporate strategy • The relative importance of the stages of FDI decision process taking account of tax considerations 	<ul style="list-style-type: none"> • Judging the integration of the tax strategy and corporate strategy • Investigating the stages at which tax strategies are considered, e.g., before the corporate strategy or after • Deciding when there is conflict of corporate strategy and tax strategy, which one is given priority



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Conclusions

- Have attempted to demonstrate a theoretical integration between tax strategy and corporate strategy in the FDI decision process.
- Firms should take account of tax issues as part of overall strategy...
- ...but do they? Short-term solutions and schemes? C.f. again Tesco.
- Relevance of tax in the FDI strategic decision process is not really addressed – but the Larimo model identifies how tax strategy can be embedded into each stage of the FDI decision process.

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QUESTIONS?

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