Who benefits from domestic firms' use of tax havens?

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Extended abstract:

Although tax-motivated profit shifting reduces the corporate tax base in high-tax countries and impacts government revenues, it is unlikely that this is the only significant impact profit shifting has. This paper focuses on the relationship between the utilization of tax havens and employee compensation. Put bluntly, if a firm saves money by not paying taxes, whose pocket is that money ending up in? There are several ways profit shifting to tax havens can affect the wages a firm pays. When a firm begins routing profits through a tax haven, this lowers its tax burden and increases its profitability. Because more profitable firms tend to pay higher wages, this can increase wage differences between haven-using firms and other firms (Saez et al., 2019). This is in addition to the wage premium generally paid by MNEs, regardless of whether they engage with tax havens or not (Gumpert, 2018). Thus, by raising profitability by avoiding taxes, profit shifting can increase income inequality across firms.

Furthermore, profit shifting can affect income inequality even within a given firm in two ways. First, executives often enjoy compensation schemes most workers do not. For example, since profit shifting increases profitability and performance, this can increase executive bonuses. Also, foreign affiliates (including those in havens) often repatriate income back to the origin country by paying dividends to shareholders, a group that often includes executives of parent companies. Thus, setting up a haven affiliate can increase executives non-wage compensation, driving up their total compensation relative to others in the same firm. This would be comparable to globalization's impact on a firm's wage distribution and top executive compensation (Klein et al., 2013, Keller and Olney, 2021).

Second, firms are not legally permitted to simply move money to a tax haven. Instead, firms must justify those transactions. This is typically done by linking the payment to trade in services, such as using a patent or other intangible asset held by the tax haven affiliate. A critical aspect of payment is determining an internal price for the service that is acceptable to the tax authority (Davies et al., 2018). Therefore, to move money to a tax haven, a firm has an incentive to develop more, and more costly, intangible assets to justify those transactions. This can increase the wages of high-skilled workers involved in developing intangibles (e.g., research scientists and software engineers). In addition, as transfer pricing often involves negotiations with tax authorities, this increases the value (and potentially wages) of accountants, lawyers, and others involved in the firm's bookkeeping. The use of a tax haven can thus increase high-income employees' wages beyond the firm's executives. The above suggests that when a firm begins shifting profits, wages for all workers may rise and that those gains are particularly pronounced for workers who are already earning the most.

We investigate this issue from multiple directions using data from Statistics Norway from 2008 onwards, where we match employee, firm, and international transactions. We define a tax haven firm in three different ways: i) cash transactions to a tax haven, ii) import of services from a tax haven, including rent payment for IP, iii) being majority-owned by a foreign shareholder. Preliminary results suggest that tax haven firms pay overall higher wage compensation to all employees but that the effect is most substantial among the already high earners. We compare the wage distribution in Norwegian tax haven firms to non-tax haven firms from 2008 onwards by matching our panel data on all international transactions by firms to employee-firm data. We define a tax haven firm in three

different ways: i) cash transactions to/from a tax haven, ii) import of services from a tax haven, including rent payment for IP, iii) being majority-owned by a foreign shareholder. We also explore the variation in tax havens' location, within or outside the EU, which makes a significant difference to the tax administration’s enforcement efforts and information access (Tørsløv et al., 2020). Preliminary results suggest that tax haven firms pay overall higher wage compensation to all employees but that the effect is most substantial among the already high earners.