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German Inbound Investment, Corporate Tax Planning, and Thin Capitalization Rules - a Difference-in-Differences Approach

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Abstract


This paper investigates tax planning behavior by means of inter-company finance and the effectiveness of fighting back via thin-capitalization rules. A simple theoretical model, which considers the financing decision of a multinational company, is used to obtain empirical implications. The empirical analysis, based on German inbound investment data from 1996 until 2004, supports a significant impact of tax rate differences on the use of intra-company debt. The effectiveness of the German thin-capitalization rule is tested by using legal amendments as natural experiments. The results suggest that the German thin-capitalization rule induces significantly lower intra-firm debt-levels of inbound investments. Hence, tax planning via intra-firm finance is effectively limited.

Keywords: Corporate Income Tax, Multinationals, Thin-Capitalization Rule, Difference-in-Differences, Firm-Level Data

JEL Classification: G32, H25, H26

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