

# **International corporations and profit shifting in Norway under the post 2006 tax regime.**

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*Previous studies have found clear differences in profitability between Norwegian and multinational firms operating in Norway under the dual income tax systems prior to 2006. Corporations that only operate in Norway are found to be the most profitable and this suggest profit shifting behavior by international firms. One problem with these studies is that none of them account for the fact that in some circumstances, it is preferable for owners who are employed in their own corporation to receive labor compensation as dividends rather than wages. This will inflate their measured profitability. I try to control for this in my empirical analysis of data between 2006 and 2011. I find that profitability in corporations where the chairman of the board also is the CEO is higher, all else equal, but I still find a lower profitability in foreign controlled firms. Surprisingly, I find no differences in profitability between domestic Norwegian and Norwegian multinational corporations.*

In a global world characterized by increased trade across borders, corporations are able to plan taxes and move income to low tax countries. During the past 12 months there have been several revelations in British media regarding large corporations and their low taxable income. Though less attention has been given to the problem in Norwegian media in the last 12 months, there have been studies which find higher profitability in Norwegian than in international corporations. This suggests that international corporations operating in Norway shift profits out of the country.

One problem with these studies is that they are all carried out under the dual income tax system of prior to 2006. Under the dual income tax system, dividends could be taxed at 28% while wages could be taxed up to 58%. It would in some circumstances be preferential for owners who were employed in the same corporations to receive labor compensation as dividends rather than wages. This would increase profitability in corporations where the owner was employed, typically small Norwegian businesses. The previously estimated profitability differential might thus be biased by owners who chose dividends as compensation.

In my thesis I use data from 2006 to 2011 where the imbalance in taxes between wages and dividends has been reduced. It is still necessary to control for such income shifting, however, as there are circumstances where it is preferential to receive compensation as dividends even after the change in tax regimes. I control for this by introducing a proxy variable which indicates whether the chairman of the board is the same person as the CEO.

Already in the descriptive analysis I find a relatively clear difference in profitability, measured as taxable income in relation to revenue, between foreign controlled and domestic Norwegian corporations. I find a smaller difference between Norwegian multinational and

Norwegian domestic corporations. It is the Norwegian domestic corporations which is the most profitable. I also find that measured profitability seems to depend on ownership, as corporations where the chairman of the board is the same person as the CEO report higher profitability.

I analyze the profitability differential further using regression techniques. The main feature of these analyses is to estimate the difference in profitability between foreign controlled firms, Norwegian multinationals and Norwegian domestic firms conditional on a set of explanatory variables. I control for sector, year, leverage ratio, tangibility ratio, size, financial income, and ownership and permanent profitability differences between firms. I find a difference of 1.09 percentage points in profitability between foreign controlled firms and Norwegian domestic firms, where the Norwegian domestic firms are the most profitable. This may be a result of profit shifting by foreign controlled firms in Norway. I find no such differences between Norwegian multinational and Norwegian domestic firms. As I assume that Norwegian owners are no less susceptible to profit shifting than foreign owners, this could be explained by the fact that for some corporations, Norway is a low tax country. These corporations would rather shift profit into Norway than out of Norway. The ownership indicator has a positive and significant coefficient, which suggests that corporations where the chairman of the board is the same person as the CEO is more profitable.

Compared to previous results I find that the difference in profitability between domestic Norwegian and international firms are smaller in absolute terms. It is however not clear how much of this reduction is due to the fact that I control for ownership and how much is due to the change in tax regime in 2006.