Corporate taxation, tax administration and development

Mohammed Mardan, ETH Zürich

This paper analyzes whether optimal tax policies, i.e. corporate income tax rates and the control of profit shifting, differ between developed and developing countries. I show that, when tax policies are fully optimized, the relation between development and both the optimal corporate income tax rate as well as the effectiveness of the tax administration follows a U-shaped pattern. However, observed tax policies partially differ from this model prediction because developing countries usually have weak administrative structures.

Because the predictions of the model are only fully consistent with the observed tax policies under the premise that governments in developing countries do not take into account the repercussion of their tax policies, the model suggests a so far unmentioned difference between developed and developing countries' optimal tax policies. Based on this insight, I show that the fight against tax havens unambiguously increases tax revenues in developed countries but has diametrically opposing tax revenue effects in developing countries.