Foreign Direct Investment Issues and Corporate Taxation

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New Zealand

The Economic Case for NOT Taxing Foreign Capital

Assume:

- 10% required rate of return.
- No tax.
- Capital moves freely between countries.
- Country A puts tax of 50% on all income derived by non residents.
- Result – much less investment.

Who are the Winners and Losers?

- Foreign investors in Country A no worse off. Now make 20% pre tax, 10% post tax return in Country A. 10% pre and post tax elsewhere.
- Workers in Country A are the losers. Less investment resulting in lower wages and/or higher unemployment.
- Capital holders in Country A are the winners. Now get 20% pre and post tax return.

Arguments Subject to Important Caveats

- No tax elsewhere in the world – no offset for domestic tax such as foreign tax credits.
- Capital moves freely between countries.
- Economic rents do not exist.

Economic Rents

- Above assumed no economic rents.
- What are economic rents? A rate of return above the required rate of return. In the example a rate of return above 10%.
- Types of economic rents: firm specific and location specific.
- Location specific economic rents the important ones.

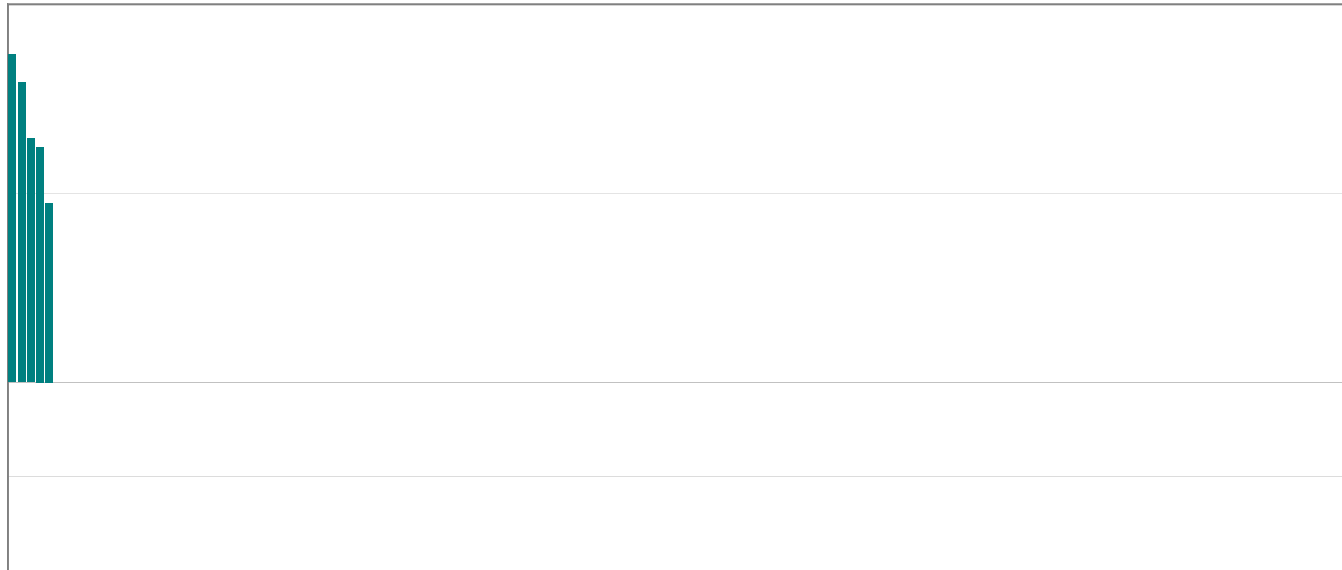
Location Specific Economic Rents

- Rents associated with locating in a specific country.
- Important if a firm must locate in the economy to sell goods or services to sell tototo

Do Location Specific Economic Rents Exist?

- Not just high returns – may be capitalised into asset prices.
- Likely to vary from country to country.
- Minerals but also brand names.

New Zealand After tax Returns on Equity



Foreign-controlled Businesses Operating in New Zealand

Relevance

- Company tax rate – lowering this loses tax on location specific economic rents.
- Articles 5 and 7 – PEs.
- Article 6 – Immovable property.
- Article 9 – Associated persons and transfer pricing. Who gets allocated income under the arm's length principle?
- Article 10 – Dividends.