

TAXATION OF FOREIGN FIRMS: DISCRIMINATIVE AND ALLOCATIVE EFFECTS: REPLY

The main objection Professor Krzyzaniak raises on that part of my paper which deals with horizontal tax equity at the international level is that the conditions I stipulate for horizontal equity are inadequate because I ignore the adjustments to the taxes and the «dynamic tax burdens» which may result and because I do not take into consideration adequately the economic conditions under which horizontal tax equity could hold.

It is true that in raising the problem of horizontal equity of international taxation in my paper I did not make any attempt to analyze the economic adjustments to taxes (shifting) and the incidence which may result. However, my intention was not to deal with this problem there¹. Perhaps the misunderstanding that I was actually dealing with this problem has arisen from the unfortunate use, somewhere in my paper, of the term «real tax burden» as an explanation of the effective tax rate, whereas this term is usually employed in situations where all adjustments have taken place.

What I intended to do with the few remarks I made on the problem of tax equity at the international level was (a) to dissolve the false impression held for long in the past that by preventing double taxation we eliminate tax discrimination and (b) to emphasize the importance of tax differentials as an

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1. The main part of the paper deals with international taxation from the point of view of allocational efficiency and, by using partial analysis, tries to find out the allocative effects of tax differentials in a model with two countries and with different marginal efficiency of investment. As for the question of equity in international taxation, the paper just raises the problem (in terms) of horizontal equity and does not proceed to further economic analysis.

important factor of discrimination. It was only for this purpose that I used the concept of horizontal tax equity. In fact, I wanted to show that even under the oversimplified assumptions of nonshifting (no adjustments to the taxes) and of complete similarity of the economies of the countries involved (assumptions implicitly made in the paper) horizontal equity is a more difficult problem at the international level than the national one, and requires additional conditions.

At the national level, there is uniformity of the tax formula and therefore firms with the same profits before taxes (first condition of horizontal equity) are subject to the same tax rate (second condition) and assuming nonshifting of taxes, they have the same profits after taxes (third condition)². At the international level, things are different. Firms with the same profits (first condition of horizontal equity) may either be taxed by two or more countries or by one, but with different tax rates in the country of origin and the country of location. In order to have horizontal equity here, even under the oversimplified assumptions we mentioned, we must (a) prevent double taxation so that international profits are taxed only by one country, and (b) coordinate (harmonize) tax systems so that effective tax rates are the same in the countries involved. It is these two conditions that I wanted to stress in my paper.

However, I quite agree that the problem needs further examination in light of all economic adjustments to taxes and under the more realistic assumptions of nonsimilarities of the economies of the countries involved. Yet consideration of all these conditions requires the use of an extremely complicated model which does not allow us to throw light on the point raised in the paper. Finally, I also agree with Professor Krzyzaniak that taking into account all the above conditions will probably lead to empty boxes.

2. This condition in my paper is stated with the term «firms under similar conditions» and is the same as the second condition of Professor Krzyzaniak. As far as his third condition is concerned, it follows from his second after the deduction of the tax burden.