Does withholding tax of interest limit international profit shifting by FDI?

JEL Classification: *F23, F38, G32*

Keywords: *withholding tax; foreign direct investments; inter-company loans; profit shifting*

Abstract

Research background: Poland is a significant recipient of intercompany loans as a part of foreign direct investment (FDI) debt instruments reported in the Balance of Payments. Most of them come from the developed West European countries – Neth-erlands, Luxembourg, France, Germany, and Belgium. Igan, Kutan, & Mirzaei (2020) confirm debt FDI inflows to emerging markets higher impact on the indus-tries' growth in the pre-crisis period 1998-2007 than after (till 2010).
Purpose of the article: We aim to identify withholding tax impact on intercorporate loans inflow to Poland and analyze the relationship between trade credit and inter-company loans to assess the importance of the profit-shifting role of FDI after 2010.
Methods: To reflect the impact of withholding tax and trade credit on intercompany loans (inward debt FDI) in 2011-2017 to Poland, we use Arellano-Bond and random effects panel model estimators. The estimated specification is derived from the knowledge-capital model and includes two types of capital: human and physical.
Findings & Value added: We show that WHT on interests reduces profit-shifting by intercompany lending by multinational companies to Poland. But intercompany loans are positively related to foreign trade credit. Unlike in the case of total FDI inward to Poland (Cieślik 2019), we identified that vertically integrated multina-tional enterprises are more likely to provide loans to Polish firms. This study is the first to confirm that withholding tax of interests reduces international profit-shifting by FDI and to provide evidence on the relationship between foreign trade credit and intercompany loans provided by multinational companies.