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INTERNATIONAL TAX COMPETITIVENESS: BETWEEN TAX OPTIMIZATION AND TAX FAIRNESS[1]

Abstract

- *Goal* – this work aims to examine tax competition between countries and the balance between tax optimization and tax fairness. The study focuses on the impact of tax competition on the allocation of foreign investment, capital mobility and the competitive advantage of the economy in the international arena, as well as on the analysis of entrepreneurs' motivation for tax optimization and its effects on public revenues and tax fairness.
- *Research methodology* – the research methodology works on a review of the scientific literature on tax competition, tax and tax optimization. These criteria are analysed on the basis of the analysis of determinants of tax competitiveness and the interaction between tax policy and the economic sphere.
- *Score/results* – the results of the analysis of the literature synthesis confirm that the increase in tax competition between countries leads to the transfer of investment allocations and, in the end, contributes to the growth of the competitive advantage of the economy on the international arena. Entrepreneurs seeking tax optimization choose a jurisdiction with the effectiveness of tax applications, and the application has an impact on public revenues and on achieving tax justice.
- *Originality/value* – the added value of this work is a new perspective on tax competitiveness and the related issues of tax optimization and tax fairness. The work also includes recommendations for policy makers, businesses and society.

Keywords: tax competition, tax competitiveness, tax optimization, tax fairness, business relocation, transfer pricing, tax haven, shadow economy.

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1. Introduction

In an increasingly globalized economy, apart from the growing freedom of trade and the progressing economic integration in the world, economic development is increasingly determined by international economic competitiveness, including tax burdens. The issue of international tax competitiveness has become the subject of intense debate as globalization and digitalisation have made it easier for businesses to operate across borders. The issues of tax regulations, taxes and interactions between tax policy and the real economic sphere are invariably important factors determining the level of competitive advantage of enterprises and the *en bloc* economy in this global arena. The discussion focuses on the delicate balance between tax optimization, where these companies seek to minimize their tax liabilities, and tax fairness. Understanding the complexity and implications of this balance is critical for policymakers, businesses and society as a whole.

On the basis of the review of scientific achievements and literature on the subject, the author of the article will discuss the tax competition between countries, including tax optimization, relocation of enterprises and issues of tax fairness. The results of the analysis can contribute to understanding the interaction between tax policy and the economy and achieving of a competitive advantage in the international arena through low and fair tax burdens. In conclusion, it was stated that low and fair tax burdens can be an important factor in stimulating investment in a country with a lenient tax regime, as well as enhancing job creation, dynamic economic growth and increasing the competitiveness of enterprises.

2. The essence of international tax competitiveness

International tax competitiveness is concerned with a country's ability to attract and retain businesses through appropriate tax policies. This includes tax rates, incentives, tax treaties and general ease of doing business. States strive to establish tax systems that attract investment and foster economic competitiveness while maintaining tax revenues.

Due to cross-border economic integration in the 20th century, the tax policy of states was based on a common tax base generated by mobile capital. Competition between countries led to the erosion of the tax base and intensified tax recourse, and became a threat to the stability of the tax system at the global

level [Avi-Yonah, 2000: 1573–1676]. Sovereign countries faced a “prisoner’s dilemma” as they feared that mobile capital and labour would react negatively to tax increases [Christensen and Hearson, 2019]. Smaller countries have benefited more from attracting foreign capital, while larger countries struggle to balance economic competitiveness with the integrity of their tax systems [Rixen, 2010].

Increased capital mobility and new business models have deepened tax competition. Reducing corporate tax rates became commonplace when income was decoupled from the base of the business. As a result, there was constant pressure around the world to lower corporate tax rates [Genschel and Schwarz, 2011; Swank, 2016]. Tax havens have used flexibility by offering the benefits of tax residence without the need to relocate people or business functions [Alstadsæter, Johannesen, Zucman, 2018: 89–100]. These benefits included low tax rates, the secrecy of hiding assets from the tax authorities, and tax eligibility rules that took advantage of differences in tax systems. The result is a new offshore space where taxes are avoided. The estimated cost of international corporate income tax is around USD 200 billion per year [Crivelli et al., 2015].

Post-crisis interventionism contrasts with the pre-crisis period [i.e. before 2008] in which tax competition was internalized [Latulippe, 2016]. Inefficient allocation of capital across countries [Clausing, 2016] leads to changes in the model of return on capital and wages and loss of income in countries with high fiscalism in favour of jurisdictions with low fiscalism or fear of insufficient supply of public goods.

Numerous studies and analyses [e.g. Laffer, Miles, 1982] focus on the impact of fiscal burdens on economic activity and state tax revenues. The Laffer curve refers to tax optimization at the macroeconomic level. Various incentives in the tax system can lead to permanent habits and reinforce certain behaviours, including negative ones. Studies conducted by Lee and Gordon [2005] and Dackehagand and Hansson [2012] showed a negative correlation between corporate income tax rates and the increase in government revenues and economic growth. Analyzes of sectors in OECD countries by Arnold and Schwellnus [2008] and Vartia [2008] confirmed the negative impact of CIT on productivity and investment.

Business is profit-driven, so tax burdens are seen as a loss of wealth. Corporate income tax reduces spending of consumers and businesses. Taxpayers try to avoid or minimize the negative effects of taxation. The responsive behaviour of taxpayers may consist of tax optimization within the limits allowed by law,

i.e. using the flexibility of the tax structure or tax-motivated migration, often referred to as relocation [Leamer, 1996; Dharmapala, Hines, 2009: 1058–1068], i.e. moving to another country. Countries compete for investors by using fiscal policy tools to increase their attractiveness. Tax competition allows mobile factors of production, such as capital, to invest efficiently in countries with low taxes. Tax competition should be treated as a manifestation of a specific struggle for potential investors and capital, for the development of a given country [Zodrow, 2006: 269].

The tax is a compulsory tax to cover public charges. The state uses parametric and economic methods of influencing taxpayers, which affect the change in expenditure [Andel and Haller, 1980: 124; Stantcheva, 2021: 2309–2369]. In the conditions of globalization, it is important to shape a tax system that is conducive to investment, innovation and job creation. An optimal tax system is key to reducing tax evasion and avoidance and shifting to the shadow economy [Torgler, Schneider, 2007].

Diversification of tax systems generates additional costs for companies operating on an international scale. Cross-border loss compensation and reduced tax compliance costs benefit corporations. According to CEPS studies, adjusting to the tax laws of different countries can cost companies between 2 and 4% of their revenues or up to 8.6 billion euro in the EU as a whole [Lanoo and Levin, 2002].

An additional cost is the time spent searching for tax breaks and tax havens, which could be better used for innovation and development. Creating a stable framework for business and supporting investment projects becomes more important in the era of globalization. Tax-friendly countries attract new investors and generate higher incomes despite lower tax burdens, thanks to economies of scale. Similarly, companies can make significant profits by offering good value for money due to large sales volumes.

International positive tax competition favours a balance between the mobility of production factors and tax revenues [Tiebout, 1956; Besley, Persson, 2009: 1218–44]. Countries compete with each other on tax rates, attracting mobile factors of production, which resembles perfect competition. A high level of available public goods can offset high tax burdens and encourage people to stay. A stable relationship between state benefits and tax burdens is crucial for factor pay.

International tax competition seeks to align tax rates at socially appropriate levels to maximize social welfare. This competition consists in attracting investors and capital, which accelerates the growth of national economies. The mobility

of factors of production, such as capital, allows them to be moved to countries with lower taxes, reducing the risk of over-taxation. The fiscal burden is often considered a key factor influencing the development of new investments in the context of tax competition [Buettner, Ruf, 2007: 151–164].

Healthy competition in fiscal policy is conducive to rationalization and the creation of a friendly business atmosphere. Competing countries strive to provide an optimal environment for enterprises and to improve the efficiency of public finance systems, which translates into improved living conditions. The competition for venture capital is not a zero-sum game with its winners and losers. It can benefit all parties involved, especially in the long term.

Unfair tax competition aims at weakening states in the fight for foreign investment, also known as "tax dumping" [Grigat, 1997: 404–414; Teather, 2002: 58–63]. In the economic literature, however, there is a different approach, according to which the reduction of tax rates for all economic entities is treated as tax competition. Tax dumping, on the other hand, concerns tax advantages granted only to foreign investors.

Tax competition can lead to a "race to the bottom" in tax rates, with countries lowering rates to keep factors of of mobile production [Razin, Sadka, 1991: 69–76]. However, the extremely zero tax that would result from this "race to the bottom" could lead to the destruction of the economy [Sinn, 1994: 85–107]. Countries with inefficient tax systems may incur wealth losses when they compete for capital gains taxes with countries with more efficient tax systems [Mendoza, Tesar, 2005: 163–204].

The comparison of nominal CIT rates is only a starting point for a comparative analysis of national tax systems. A complete picture of the corporate tax burden requires consideration of differences in the calculation of the tax base, such as the range of costs, the method of depreciation, provisions, losses and tax credits.

The full picture requires a comparison of the effective, not the nominal, tax rate. Companies will be willing to relocate to countries with a more favourable effective tax rate as part of foreign direct investment.

3. Optimization and its rationale

Tax optimization, also known as tax planning, is the implementation of a legal strategy to introduce a tax obligation in the light of tax regulations. Businesses embrace tax optimization, often underpinning tax rates, tax laws, and loopholes

between jurisdictional agencies to manage general taxation. Optimization enables companies to efficiently allocate resources and funds for innovation, growth and job creation. Thus, tax optimization is used for tax planning, the purpose of which is to create structures and special legal regulations related to the core activity that can be introduced by taxpayers [Diamond, Mirrlees, 1971: 8–27; Gruziel, 2009: 175–186]. Optimization of taxation consists in the selection of solutions that will enable you to take advantage of the aid or make it charged as part of the amount offered. Therefore, these are activities aimed at minimizing financial resources through the selection of legal acts and the selection of tax policy instruments that cover the total amount of taxes and thus maximize the net profit. The basic instruments of tax optimization [cf. Gravelle, 2009: 727–753] include:

- instruments of fundamental importance – they concern the main structural and organizational decisions affecting the entire tax strategy of the company, such as the choice of tax jurisdiction, ownership structure, method of operating organization, selection or change of the organizational and legal form;
- comprehensive instruments – these are more complex strategies that require more advanced planning and implementation, as well as taking into account various legal, financial and operational aspects, including change of the tax year, selection of the depreciation method, the method of settling the tax loss or the selection of the form of payment of tax advances, application of systemic tax preferences, transfer pricing planning;
- instruments of current tax optimization – they can be used more operationally and faster to minimize the tax burden as part of the company's current operations, e.g. control of the formation of tax revenues and tax costs, an entry in the register of fixed assets, forms of establishing an employment relationship with employees or the choice of the form of investment financing.

Tax optimization boils down to achieving maximum tax revenues with the lowest possible tax burden on taxpayers, which would not constitute a barrier to the dynamic development of entrepreneurship and economic growth [Kulawczuk, 2004: 29]. On the other hand, with the constant increase in the tax burden, relocation may also constitute a serious threat to the stable development of the country, i.e. the transfer of economic activity to the countries with low taxes.

Undoubtedly, every rational entrepreneur will strive to minimize his tax burden. However, the problem remains to define the limits of acceptable activities that can be considered as such optimization, because the pursuit of tax opti-

mization can sometimes lead to unintended consequences. Some entrepreneurs may exceed these limits, which will be reflected in aggressive tax optimization [Lang, Owens, 2014; Kleinbard, 2014: 14–26], tax evasion, activities in the shadow economy, and even tax fraud. Aggressive tax planning practices such as profit shifting and base erosion, can reduce countries' tax revenues, leading to concerns about tax fairness and undermining public confidence in the tax system.

Aggressive tax optimization is a problem for both the taxpayer and the state. It is also a matter of harmful tax competition in the international dimension, where entities applying such optimization operate cross-border, both within and outside the EU. Since there is no uniform tax policy even in the EU, some countries have a relatively liberal policy in this respect, which does not discourage taxpayers from tax avoidance.

Any corporation with branches or subsidiaries in multiple countries is tempted to report profits in the countries with the lowest tax burden. However, other activities that are already crimes, and thus go beyond what is permitted by law, will be referred to as tax evasion, extortion or even tax fraud. For this purpose, the Act provides for criminal and fiscal liability.

The issues of tax avoidance and the development of the shadow economy are among the most important topics related to the implementation of fiscal policy. Both public authorities and researchers strive to limit the scope of this phenomenon by formulating an appropriate definition, measuring and detecting its causes. To avoid the negative consequences of tax optimization by entrepreneurs, it is necessary to find a balance that ensures that companies pay a fair share of taxes while supporting economic growth and investment.

4. Tax fairness and its imperatives

Tax fairness embodies the fundamental principle that the tax burden should be distributed fairly between individuals and businesses, based on their ability to pay. It emphasizes the idea that those who use the country's resources, infrastructure and legal systems should contribute proportionately to their maintenance and should contribute their fair share to the financing of public goods and services. Achieving tax fairness is not only a matter of economic fairness but is also crucial for social cohesion and the sustainability of public finances.

Already in antiquity, Aristotle pointed out that justice is a virtue of the spirit that allows you to achieve harmony. The application of justice in interpersonal

relations allows for the cooperation of the entire society in the structures of the state [Szumlakowski, 2013: 115; Aristotle, 1996: 167–185]. According to J. Rawls, social justice means that all citizens have equal opportunities to achieve success and achieve their life goals [Rawls, 2019].

Justice in the concept of public finance law science should be perceived through the prism of the amount of taxes and emerging legal problems with an even burden of taxes on society. The choice of a fair formula should create conditions affecting the functioning of social assistance [Nowak-Far, 2011: 26]. The principle of tax justice is a specification of the principle of social justice in the context of the fairness of citizens' fiscal burdens, but it does not mean granting equal rights and obligations to all citizens.

A. Smith argued that "[...] the subjects of each state should contribute to maintaining the government as close as possible to their ability, i.e. in proportion to the income each of them receives under the care of the state" [Smith, 2007: 500–501]. In turn, according to F. Neumark, the optimal budget in terms of taxation is only one that does not violate the limits (sources) of taxation, and at the same time secures the implementation of necessary public tasks [Neumark, 1957: 450]. An excessive increase in the tax burden as a result of strong progression could result in resistance to paying taxes and a reduction in tax revenues [Neumark, 1981: 8].

A. Wagner and J.-B. Say, who advocated the use of tax progression in the tax system, thus giving taxes a social function [cf. Wagner, 1880: 169], understood the issue of equality and the pursuit of the ideal of fair taxation in a completely different way.

One way or another, achieving tax justice is not easy, there are no universal methods and ways to achieve it, but the choice of a fair taxation formula should create conditions affecting the functioning of social assistance.

In the literature on the subject, there are two independent concepts of justice in the sense of equality. They are: horizontal justice and vertical justice [Musgrave, 1990]. Horizontal justice consists in the equal treatment of equals (i.e. individuals who are identical in all material respects) and manifests itself in the application of a relatively low, proportional flat rate in taxation with a broad and equal tax base. In turn, the principle of vertical justice consists in differentiating taxation by what is unequal in tax terms; this is reflected in a relatively strong progression and a large number of various tax reliefs and exemptions. However, the following problems arise: who should pay higher taxes, how to formulate appropriate laws and how to determine how much more an individual should

pay if they can [Stiglitz, 2019: 565–567]. There is a division as to the degree of progression, but there is a consensus as to the harmfulness of a steep progression for tax sources and entrepreneurship.

According to L. Murphy and T. Nagel, private property is a legal convention, partly defined by the tax system, and thus the tax system cannot be assessed by analyzing its impact on private property, understood as something that has an independent existence and validity. Taxes should be assessed as a part of the general property rights system they help to create. Tax justice or injustice can only mean fairness or injustice in the system of property rights and entitlements resulting from a specific tax system. In their opinion, the value that guides tax policy should be social justice, not tax justice [Murphy, Nagel, 2002: 8].

Nowadays, the principle of fair taxation boils down to the fact that a given tax does not cause excessive burdens for the state and is evenly distributed and adjusted to the possibility of paying it by a given taxpayer. In addition, the construction of the tax must guarantee its universality, as well as eliminate or hinder the transfer of taxes to others than those who, according to the intention of the legislator, are to bear the tax.

Precisely from the social point of view, tax fairness means combating tax avoidance and evasion and combating income inequality. When multinational corporations engage in aggressive tax planning, exploiting tax havens and loopholes, this can undermine tax fairness by shifting the burden to smaller businesses and individual taxpayers who do not have the resources to implement similar strategies. This imbalance can exacerbate income inequalities and hamper social progress.

5. Striking the balance

Tax optimization is an integral part of the strategic financial planning of enterprises. Companies have a fiduciary duty to their shareholders to maximize profits and minimize costs, including tax expenses. By employing legal tax planning strategies such as structuring business operations, using tax incentives and examining international tax treaties, companies can increase their competitiveness and profitability. While tax optimization is essentially a legitimate practice, excessive tax planning or abuse can undermine tax fairness and public confidence in the tax system.

Therefore, striving to increase a country's international tax competitiveness often faces several challenges, primarily due to the increasing complexity of global tax systems and the evolving nature of business operations. Base erosion and profit shifting (BEPS), where multintional corporations exploit loopholes and discrepancies to shift profits to low-tax jurisdiction, constitute significant challenges. This leads to a loss of revenue for countries, which in turn leads to concerns about achieving tax justice and an erosion of public confidence in the tax system. Therefore it is necessary to find a balance that, on the one hand, ensures that businesses pay their fair share of taxes, and, on the other hand, supports economic growth and investment. From a social perspective, tax fairness means overtly combating tax evasion, but it can also mean indirectly reducing tax avoidance.

Finding the right balance between tax optimization and tax fairness is a complex and multifaceted endeavour. It requires governments, international organizations and businesses to work together to create a framework that promotes economic growth while ensuring a fair distribution of the tax burden. Several approaches can contribute to achieving this balance:

1. International cooperation: encouraging countries to cooperate in the fight against tax evasion, profit shifting and harmful tax practices through OECD initiatives such as the *OECD/G20 Base Erosion and Profit Shifting Project* [OECD, 2015], which can ultimately foster a level playing field actions and reduce aggressive tax planning. This cooperation may also include the exchange of tax information, the harmonization of tax rules and the promotion of a multilateral approach to combating tax evasion.
2. Regulatory reforms – simplification and transparency: Policymakers can implement reforms that close tax loopholes, strengthen anti-avoidance measures and simplify tax systems. Simplifying tax systems and increasing transparency can stop tax fraud. Enforcement measures, such as country-by-country reporting where companies disclose financial information, can provide tax authorities with insight into the activities of multinational corporations and ensure fair taxation. By reducing the complexity and increasing the transparency of the system, these reforms can promote tax fairness and restore public trust in the tax system.
3. Fair taxation of the digital economy: The digital economy presents challenges in terms of the effective taxation of digital businesses. International consensus and cooperation are needed to develop new tax rules that recognize the value created by digital companies and ensure their fair contribution to the countries where they operate. Updating the tax rules

to reflect the unique challenges of the digital economy can help address the taxation of digital businesses effectively. Initiatives such as the OECD's ongoing work on digital taxation aim to ensure that digital businesses contribute their fair share.

4. Public discourse and awareness: Engaging in open public discourse and raising awareness about the importance of tax fairness and the consequences of aggressive tax planning can foster a sense of social responsibility among businesses and individuals. This can ultimately lead to a collective commitment to support a fair tax system.
5. Multilateral efforts: Promoting multilateral agreements and treaties to prevent harmful tax competition can discourage countries from engaging in a downward race in tax rates. This approach fosters collaboration, minimizes profit-shifting opportunities and supports global tax fairness.

6. Conclusions

The intensification of the globalization process in the business sphere, and, in particular, the increasing mobility of the allocation of production factors, forces the government to offer potential investors more favourable taxation, and thus creates a kind of "tax fight" and tax competition between countries. Creating a stable framework for economic activity and supporting investment and development projects is becoming increasingly important today because the globalization of economic processes eliminates those who cannot keep up with the competition and do not gain a sustainable competitive advantage.

In the era of globalization of economic processes, competition between enterprises is based primarily on the quality of manufactured goods, provided services and their price. The role of public authorities in this respect comes down to, on the one hand, creating conditions for reducing the costs of running a business and increasing their economic efficiency, and on the other hand, encouraging entrepreneurs to invest in technological development and job creation. Decisions made by the state in the field of tax policy cannot be overestimated, because taxes play not only a fiscal role but also a social one (they eliminate excessive differences in the income structure of the population] and an economic one (they stimulate the behaviour of business entities).

Tax-competitive countries usually have a smaller range of the informal economy and greater development opportunities to bridge the gap with more devel-

oped countries. Countries with higher tax revenues, due to lower taxation, the smaller scale of legal regulations and simpler regulations, as well as lower levels of corruption, tend to have lower levels of the informal economy. Entrepreneurs operating in their area are usually less inclined to optimize taxation because the cost of such activities is too high for the benefits obtained from unpaid taxes. It is important to create mechanisms and procedures to eliminate dishonest players from the market and to support economically effective players. This is all the more important as overly restrictive tax regulations may limit the benefits of globalization and limit the inflow of foreign direct investment, which in developing countries with low equity resources may cause a slowdown in economic growth.

It is important to realize that achieving the perfect balance between tax optimization and tax fairness is a complex task. Different countries have unique economic and social conditions, and their tax systems will reflect these differences. However, through continued dialogue, cooperation and commitment to tax transparency and fairness, nations can strive for a fairer and more competitive global tax landscape.

In conclusion, international tax competition requires a thoughtful approach that balances the optimization of tax liabilities with the principles of tax fairness. By tackling challenges, implementing reforms and fostering international cooperation, governments can create an environment conducive to investment, economic growth and fair taxes, promoting a sustainable and prosperous global economy.

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