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The impact of tax shields on bankruptcy risk and resource allocation

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RESEARCH QUESTION & POLICY RELEVANCE

This paper asks how tax rules on past losses affect whether struggling firms survive or go bankrupt. It focuses on what happens when governments make it harder for companies to use earlier losses to reduce future tax payments, and why this may matter especially for firms that are part of larger corporate groups.

ANALYSIS

Using data from firms across 29 European countries, the paper studies how companies were affected when these tax rules became stricter. It also compares standalone firms with firms inside business groups to understand how internal support within groups shapes firm survival.

IMPACT

The paper shows that stricter rules increase bankruptcy risk, particularly for firms that belong to business groups. At the same time, productivity rises in sectors where many firms carry large past losses. The findings suggest that tax relief can help weak firms survive, but may also slow the shift of resources toward stronger and more productive businesses.

AUTHOR QUOTE

> "My findings suggest that in Europe, at least until 2018, more generous tax loss offset rules helped firms avoid bankruptcy but also decreased efficient capital allocation because market-wide productivity decreased. This is likely because larger firms engaged in tax planning and thereby helped unproductive business units stay alive. So, there is a clear trade-off in tax policy when it comes to loss making firms!"
>
> - Marcel Olbert

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