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Before the
United States Senate Committee on Finance
Hearing on International Corporate Taxation

July 22, 2014

Chairman Wyden, Ranking Member Hatch, and distinguished members of the Committee, it is an honor to appear today to testify on the important topic of international corporate taxation. I am an associate professor at the Tuck School of Business at Dartmouth College. I teach financial accounting and taxation and my research centers on multinational corporations (MNCs). The views I am expressing are my personal views.

Abandoning our current approach to international corporate taxation in favor of one of the many alternatives would be a major policy move and deserves careful analysis. It is clear that reform is needed – the international system is one of the most technically complex areas of the U.S. tax code but raises little revenue.

In this testimony, I would like to offer my views on: (i) the problem(s) with the current system, (ii) some strengths and weaknesses of reform alternatives, and (iii) financial reporting considerations when formulating international tax policy. As my views are shaped by my own research and the research of my colleagues, I will summarize extant work guiding many of the assessments I offer in my testimony.

A. What is the problem with the current system of U.S. international corporate taxation?

Comparative tax burdens

Public debate surrounding reform of U.S. international corporate taxation often features claims that the current system is not ‘competitive’. The top U.S. federal corporate income tax rate is 35 percent. At present, this is the highest federal tax rate of all OECD countries, and far exceeds the 23.5% average of all other OECD countries. Generally speaking, U.S.-based MNCs face this relatively high tax on worldwide profits, whereas non-U.S.-based MNCs face a relatively low tax on domestic profits and no residual home country tax on foreign profits. Thus, a common assertion is that U.S. MNCs are at a competitive disadvantage because they face larger corporate tax burdens than their competitors under a worldwide, rather than territorial, tax system.

Yet there is no evidence to support this assertion. Some studies compare global accounting effective tax rates (ETRs) across countries with the goal of informing the

debate on competitiveness.¹ Markle and Shackelford (2011) finds that firms resident in countries with a worldwide tax system have ETRs that are 1.4% lower than firms resident in countries with a territorial tax system.² Avi-Yonah and Lahav (2011) finds that U.S. MNCs have ETRs that are 4% lower than MNCs based in the EU.³ Finally, Maffini (2012) finds that, after controlling for statutory tax rates in the home country, there is no difference in ETRs of firms operating under a worldwide versus territorial tax system.⁴

The issue of competitiveness is often raised when advancing reform towards adoption of a territorial system. Embodied in such a system is the concept of capital import neutrality that requires the same tax on firms with different nationalities that invest in a given location. Comparing global ETRs will not detect violations of capital import neutrality because they, in part, reflect differences in location decisions.

Since each MNC has a different geographic footprint, a comparison of ETRs within a single jurisdiction operated by MNCs resident in different countries would seem more appropriate. For instance, how does the tax burden (including both source and host country taxes) on operations in a given country compare between U.S. MNCs and non-U.S. MNCs?⁵ We do not know the answer to this question, nor is there good data to answer it. At best, we observe the source country tax, but do not observe any home country tax imposed on profits earned in a specific country.

Both Markle and Shackelford (2011) and Maffini (2012) move closer to making the relevant comparison when they examine the impact of location decisions on global ETRs for firms resident in different countries. The former study finds that by operating a subsidiary in the Netherlands, a U.S. firm reduces its global ETR by 0.1% whereas a Swedish firm lowers its global ETR by 7.3%. The latter study finds that a tax haven subsidiary yields a greater reduction in the global ETR for territorial firms, relative to worldwide firms. The reality is that we know very little about how the tax burden in any particular jurisdiction depends on the parent company's country of residence.

There is no evidence that U.S. MNCs face greater tax burdens as a consequence of how foreign profits are taxed, relative to their competitors. Further, researchers

¹ Due to the ability to defer tax expense recognition for expected U.S. repatriation taxes under APB 23 in U.S. firms' financial statements, accounting ETRs will not reflect the expected residual U.S. tax, which may be indefinitely deferred. Thus, APB 23 puts U.S. MNCs 'on par' with MNCs based in territorial countries in terms of the accounting ETR.

² Markle, Kevin, and Douglas Shackelford (2011). Cross-Country Comparisons of Corporate Income Taxes, NBER Working Paper 16839.

³ Avi-Yonah, Reuven, and Yaron Lahav (2011). The Effective Tax Rate of the Largest US and EU Multinationals. University of Michigan Public Law Working Paper 255.

⁴ Maffini, Giorgia (2012). Territoriality, Worldwide Principle, and Competitiveness of Multinationals: A Firm-Level Analysis of Tax Burdens. Centre for Business Taxation WP 12/10.

⁵ It is entirely possible that, for a given profit generated in a low-tax country, a non-U.S. MNC faces a higher tax burden due to 'strong' anti-abuse rules taxing those source country profits in the MNC's home country, while the U.S. firm faces indefinite deferral of home country tax under 'weak' anti-abuse rules.

cannot make comparisons by jurisdiction that would seem necessary to resolve the competitiveness issue. This is of particular importance when the public debate frames the problem with the current tax system as violating capital import neutrality and calls for the adoption of a territorial tax system.

The implicit cost of tax deferral

The burden associated with the current U.S. system includes both the explicit residual tax on actual repatriations and the implicit cost of avoiding repatriation. The explicit cost of the repatriation tax would show up in firms' ETRs, but the implicit cost of avoiding the tax would not. Such implicit costs might include high leverage in the U.S. to finance domestic investment, or making foreign investments with lower rates of return than could be earned domestically. Thus, it may be more fruitful to search for evidence that the U.S. tax system lacks competitiveness by examining implicit, rather than explicit, costs.

The implicit tax associated with avoiding repatriation is estimated at about 1% of pre-tax income (1.7% in tax havens).⁶ However, the unexpectedly large repatriations under the 2005 tax holiday that reduced the repatriation tax rate to 5.25% suggests that these estimates are too low. The reason is that MNCs will not repatriate until the effective tax rate on locked-out earnings falls below the cost of deferral.

In light of the tax holiday, Grubert and Altshuler (2008) re-examines these estimates and finds that the implicit costs are increasing in the stock of deferrals, an issue that was previously not considered.⁷ That is, the cost of using complex structures to avoid repatriation taxes increases as the amount of undistributed earnings rises. Consistent with this, Lewellen and Robinson (2013) documents a significant difference in both the size and age of foreign operations between U.S. MNCs that use complex internal ownership structures (i.e., affiliates are indirectly owned by the parent), relative to those that do not.⁸

An important implicit cost of deferral is the failure to allocate economic resources in an efficient manner. As U.S. taxation of foreign earnings only takes place when earnings are repatriated, firms have incentives to keep foreign earnings abroad. As a consequence, in times of limited foreign investment opportunities and high profitability, these funds are likely to be held abroad in the form of cash – referred to as the “lock out” effect or “trapped cash”. Foley, Hartzell, Titman, and Twite (2007) finds that the repatriation tax

⁶ Grubert, Harry, and John Mutti (2001). Taxing International Business Income: Dividend Exemption versus the Current System. American Enterprise Institute, Washington DC.; Desai, Mihir, Fritz Foley, and Jim Hines (2001). Repatriation Taxes and Dividend Distortions. *National Tax Journal* 54 (4), 829-851.

⁷ Grubert, Harry, and Rosanne Altshuler (2008). Corporate Income Taxes in the World Economy: Reforming the Taxation of Cross-Border Income. In Diamond, John W. and George R. Zodrow (eds.). *Fundamental Tax Reform: Issues, Choices, and Implications*, 319-354. MIT Press, Cambridge, MA.

⁸ Lewellen, Katharina, and Leslie Robinson (2013). The Internal Ownership Structures of Multinational Firms. Tuck School of Business working paper.

helps explain cash holdings abroad in U.S. MNCs.⁹ Hanlon, Lester and Verdi (2014) and Blouin, Krull, and Robinson (2014) develop proxies for trapped cash in U.S. MNCs and examine the economic effects of these cash holdings.¹⁰

Hanlon et al. documents that foreign acquisitions are more likely for firms with trapped cash, and that market reaction to the announcement of such acquisitions is negative. The inference is that foreign investments financed by trapped cash are value decreasing, possible reflecting agency issues. Blouin et al. documents that domestic investment of firms with trapped cash is less responsive to U.S. investment opportunities and is more sensitive to domestic cash flows than foreign cash flows. Further, this finding holds only in a sample of financially constrained firms (i.e., those with limited access to external capital markets). The authors conclude that trapped cash creates frictions in firms' internal capital markets.

There is also evidence consistent with the implicit cost of the lock out effect making U.S. MNCs less competitive in the market for corporate control. Huizinga and Voget (2009) finds that countries with worldwide tax systems are less likely to attract the parent companies of newly created MNCs following cross-border M&A transactions.¹¹ They estimate that U.S. adoption of a territorial system would increase the proportion of cross-border takeovers resulting in a U.S. parent firm from 53% to 58%. Feld, Ruf, Scheuering, Schreiber, and Voget (2013) finds that the number of cross-border M&A transactions featuring a Japanese or UK acquirer increased after these countries adopted a territorial system. Based on their results, they estimate that U.S. adoption of a territorial system would increase the number of cross-border transactions featuring a U.S. acquirer by 17%.

Balakrishnan, Blouin, and Guay (2012) documents another implicit cost by showing that firms engaging in more extensive tax planning have less transparent (internal and external) information environments due the organizational complexities associated with implementing various tax strategies.¹² Finally, Creal, Rogers, Robinson and Zechman

⁹ Foley, Fritz, Jay Hartzell, Sheridan Titman, and Garry Twite (2007). Why Do Firms Hold So Much Cash? A Tax-Based Explanation. *Journal of Financial Economics*, 86 (3), 579-607. However, this role of taxes is challenged in a recent working paper that compares cash holdings across firms resident in different countries. The authors find a number of results inconsistent with tax-induced cash holdings in MNCs resident in different countries. See Pinkowitz, Lee, René Stulz, and Rohan Williamson (2012). Multinationals and the High Cash Holdings Puzzle. Ohio State University working paper.

¹⁰ Hanlon, Michelle, Becky Lester, and Rodrigo Verdi (2014). The Effect of Repatriation Tax Costs on U.S. Multinational Investment. *Journal of Financial Economics*, forthcoming; Blouin, Jennifer, Linda Krull and Leslie Robinson (2014). The Location, Composition, and Investment Implications of Permanently Reinvested Earnings. University of Pennsylvania working paper.

¹¹ Huizinga, Harry, and Johannes Voget (2009). International Taxation and the Direction and Volume of Cross-Border M&A. *Journal of Finance* 64(3), 1217-1249; Feld, Lars, Martin Ruf, Uwe Scheuering, Ulrich Schreiber, Johannes Voget (2013). Effects of Territorial and Worldwide Corporation Tax Systems on Outbound M&As. ZEW Discussion Paper 13-088.

¹² Balakrishnan, Karthik, Jennifer Blouin, and Wayne Guay (2012). Does Tax Aggressiveness Reduce Financial Reporting Transparency? University of Pennsylvania working paper.

(2014) fail to find evidence that the valuation premium in U.S. MNCs, relative to the value of a benchmark portfolio of firms operating independently in the same geographic footprint, is associated with the MNCs ability to shift income, suggesting that implicit costs reduce the value of tax benefits from shifting income.¹³

There is evidence supporting the notion that U.S. MNCs face non-trivial implicit costs of deferral that may put them at a competitive disadvantage, but there is no comparison of these costs to MNCs based in other countries. Competing firms operating under territorial tax systems may also bear implicit costs of avoiding home country tax through the need to navigate anti-abuse rules in the home country. The implicit cost is assumed to be low for non-U.S. MNCs, relative to U.S. MNCs. However, the validity of this assumption is not clear.

Corporate inversions

A recent wave of ‘inversions’ is underway, urging policymakers to enact U.S. tax reform quickly. However, to my knowledge, there is no good data compiled indicating the extent of U.S. MNCs’ involvement in inversion transactions as compared with non-U.S. MNCs, nor a thorough understanding of the precise tax motivations for the relocation choice. Voget (2011) reports that 6% of a sample of about 2,000 MNCs from 19 countries inverted over the period 1997-2007.¹⁴ Interestingly, 10% of the sample relocated from the U.S. to another country, while the remaining firms were initially based in other EU countries, including EU tax havens. Thus, not all inversion transactions follow the fact pattern generally documented in the recent business press.¹⁵

Of the 27 firms that relocated from the U.S., 6 relocated to the U.K., 5 to France, 4 to Canada, and 4 to Germany. Though none of these countries has a particularly low statutory rate, they all operate a territorial tax system. Voget (2011) documents that both home country taxes on the repatriation of foreign profits and the introduction of controlled foreign corporation (CFC) legislation have a positive effect on the probability of relocation. Thus, it is not only the existence of a worldwide system that provides incentives for firms to relocate, but also the existence of anti-abuse legislation.

Similarly, Markle and Robinson (2012) examine the use of tax haven subsidiaries across MNCs based in 28 countries and document that both the existence of a worldwide system, and the existence of CFC legislation, reduces the probability of tax haven use. Moreover, Markle and Robinson consider the ‘strength’ of countries’ CFC legislation by creating an index based on whether seven types of provisions contained in the legislation

¹³ Creal, Drew, Jonathan Rogers, Leslie Robinson, and Sarah Zechman (2014). The Multinational Advantage. University of Chicago working paper.

¹⁴ Voget, Johannes (2011). Relocation of Headquarters and International Taxation. *Journal of Public Economics* 95 (9-10), 1067-1081.

¹⁵ E.g. Hoffman, Liz, and Hester Plumridge (July 14, 2014). “Race to Cut Taxes Fuels Urge to Merge” Wall Street Journal.

are likely to broaden the tax base. In subsequent analyses, the authors find that ‘stronger’ CFC legislation, as opposed to simply its existence, is associated with a lower probability of tax haven use. Interestingly, the U.S. ranks right in the middle, in terms of the strength of its CFC legislation, among the 18 countries in the sample with CFC legislation.

The significant number of recent actual or proposed inversions by U.S. companies is likely a signal that tax reform is needed soon. However, it would be useful to have comparative data on the extent to which non-U.S. firms are currently engaging in corporate inversions. This would be an indirect way of evaluating the implicit costs of avoiding home country tax on foreign source income across MNCs based in different countries. Note that even firms in territorial countries likely bear implicit costs associated with circumventing anti-abuse rules.

Overall, the problem is that a relatively high tax rate and worldwide system with deferral creates incentives to shift income (and real economic activity) to low-tax countries, and discourages repatriation. Research offers considerable support that the present system raises little revenue, is complicated, creates incentives for income shifting, and interferes with companies’ efficient use of capital as they try to avoid the repatriation tax. However, research offers little in the way of guidance as to how things would look under an alternative system. Moreover, comparisons of the U.S. to other countries, or worldwide countries to territorial countries, have only limited use because the U.S. differs from other countries along many important dimensions. Finally, all countries, in practice, use a hybrid system with anti-base erosion rules that broaden or narrow the tax base, limiting inferences made from comparisons between worldwide and territorial systems.

B. What are some of the strengths and weaknesses of reform alternatives?

Territorial taxation versus worldwide taxation

A recent KPMG survey of nearly 1,700 tax professionals and senior executives indicates that 49% are in favor of a relatively pure territorial tax system, 16% are in favor of the current system of worldwide taxation with deferral, 3% are in favor of a relatively pure worldwide system (without deferral), and 27% are unsure. It is not surprising to see many more members of the business community interested in a pure territorial system than a pure worldwide system, but preferences become less clear when proposals to lower the statutory rate under a pure worldwide system and introduce anti-based erosion legislation under a territorial system enter the picture.

Appropriately framing the objective of tax reform is important when choosing among alternative solutions. If the objective were to make U.S. firms more competitive by reducing the U.S. tax burden on their foreign income, then this would naturally lead one to want to support the adoption a territorial system. However, if the goal is to reduce the

implicit costs of avoiding the repatriation tax, the path forward becomes less clear. That is because this goal can be achieved either by maintaining a worldwide system but eliminating deferral, or by adopting a territorial system.

It is also important to keep in mind that worldwide versus territorial systems are methods for alleviating double taxation of income. When framed in this fashion, it seems reasonable that a well-designed territorial system would appropriately limit eligibility for dividend exemption to income that has been subject to a robust tax system abroad. Thus, as eligibility becomes more and more restrictive on certain types of income taxed at low rates abroad, the pendulum swings back to that resembling a worldwide system without deferral.¹⁶ Thus, it is possible for a well-designed territorial system to be more burdensome on a U.S. MNC than the poorly designed worldwide system we have now.

Territorial taxation and incentives to shift income

The first major concern with adopting a territorial tax system is that it will increase incentives to shift income to low-tax jurisdictions. The validity of this concern depends on (i) the new U.S. statutory tax rate, (ii) the anti-base erosion rules in place, and (iii) the extent to which U.S. firms are shifting income under the current tax system.

There is an extensive literature consistent with income shifting in MNCs. Estimates of the magnitude and trend in income shifting differ across studies that examine U.S.-based MNCs versus EU-based MNCs. In a sample of EU-based MNCs, a 10% decrease in the tax rate is associated with an increase in reported income ranging from 4% to 13%. These studies indicate that profit shifting is decreasing over time.¹⁷ Research using a sample of U.S. MNCs paints a different picture. In particular, Klassen and LaPlante (2012) report a larger semi-elasticity of 17% and show that U.S. MNC profit shifting is increasing over time.¹⁸

Two studies attempt to compare income shifting by firms subject to a worldwide versus territorial system. Markle (2012) estimates the extent of income shifting in a sample of MNCs resident in different countries. Territorial firms engage in more shifting than *financially constrained* worldwide firms, while there is no difference between territorial firms and *financially unconstrained* worldwide firms.¹⁹ If a firm can access

¹⁶ In other countries, the scope of their territorial systems differs based on how broadly or narrowly the eligibility rules are for the exemption. Take Japan for instance, with a 20 percent minimum tax. This resembles a worldwide system without deferral, at least with respect to activity in low-tax jurisdictions.

¹⁷ Huizinga, Harry, and Luc Laeven (2008). International Profit Shifting Within Multinationals: A Multi-Country Perspective. *Journal of Public Economics* 92 (5-6), 1164-1182; Lohse, Theresa, and Nadine Riedel (2013). Do Transfer Pricing Laws Limit International Income Shifting? Evidence from European Multinationals. CESifo working paper 4404.

¹⁸ Klassen, Ken, and Stacie LaPlante (2012). Are U.S. Multinational Corporations Becoming More Aggressive Income Shifters? *Journal of Accounting Research* 50 (5), 1245-1285.

¹⁹ Markle, Kevin (2012). A Comparison of Tax-Motivated Income Shifting of Multinationals in Territorial and Worldwide Countries. Oxford Centre for Business Taxation Working Paper 12/06.

external capital or generate sufficient internal domestic capital to fund their domestic investments, the repatriation tax should have no effect on the firm's investment. Using financially unconstrained U.S. MNCs as a proxy for how U.S. MNCs would behave under a territorial system, Dyreng and Markle (2013) estimate that constrained MNCs would shift up to 19% more income out of the U.S. under a territorial system.²⁰

Incentives to shift income out of the U.S. would likely increase for financially constrained firms under a territorial system. Incentives to shift income would also still exist for firms with excess foreign tax credits under a worldwide system without deferral. However, these incentives would depend on the new U.S. statutory tax rate (under a worldwide system without deferral, the rate would determine the number of firms with excess foreign tax credits). Proposals differ on the new U.S. statutory tax rate – for instance, the Camp proposal sets the new rate at 25% while the Obama proposal sets the new rate at 30%. A reasonable rate would be one that approximates the actual effective tax rate on foreign income under the current system.

These incentives also depend on anti-base erosion legislation in place under a territorial system. The Camp proposal, for instance, appropriately introduces such anti-base erosion provisions. However, many of these provisions would be difficult to enforce, and would present new opportunities for tax planning.

Territorial taxation and intellectual property

A second major concern with adopting a territorial tax system is that it will increase incentives to shift royalty income out of the U.S. in order to turn it into tax-exempt dividend income. This would most likely be accompanied by a shift in real R&D activities abroad. Moreover, this incentive will be stronger for U.S. MNCs shielding their royalty income using excess foreign tax credits under the existing system.

The Camp proposal appropriately addresses this issue with three possible anti-abuse rules. Options that reduce the effective tax rate on intangible income may be likely to keep R&D operations in the U.S. that are most likely to contribute to the U.S. economy. Christof, Richter, and Riedel (2013) finds that reducing income tax rates on R&D output (as opposed to other incentives) attracts relatively more innovative projects with higher earnings potential.²¹

Taxing the existing stock of undistributed earnings

A final issue, regardless of the new tax system, is how to treat the current stockpile of undistributed foreign earnings. Various proposals differ on this issue. For instance, under

²⁰ Dyreng, Scott, and Kevin Markle (2013). The Effect of Financial Constraints on Tax-Motivated Income Shifting by U.S. Multinationals. Duke University working paper.

²¹ Ernst, Christof, Katharina Richter, Nadine Riedel (2013). Corporate Taxation and the Quality of Research and Development. CESifo working paper 4139.

the Camp proposal, the undistributed earnings would be subject to tax at the rate of 5.25% and the tax obligation could be paid over 8 years. The foreign dividends, when repatriated under the new exemption system, would then be subject to an additional tax at the rate of 1.25% (25%*5%). The Baucus proposal would subject undistributed earnings to a one-time tax at a rate of 20%, as would the Obama proposal. Each proposal trades off being harsh compared to the current system (under which many firms may never repatriate) with providing unnecessary windfall benefits.

It is important, when deciding how to tax currently undistributed earnings, to understand (i) the size of the potential pool of earnings, (ii) the effective tax rate on those earnings, and (iii) the extent to which earnings are tied up in a non-liquid form. Blouin, Krull, and Robinson (2014) provide an analysis of permanently reinvested earnings (PRE) in a sample of 870 large U.S. MNCs and report that the aggregate ratio of PRE to foreign retained earnings is 59%, 24% of PRE is held in tax havens, and 45% of PRE is held in liquid assets. These descriptive data suggest that the pool of undistributed earnings that would be subject to tax is larger than PRE, not all PRE will have a significant residual tax liability associated with it, and the imposition of a transition tax on PRE is not likely to create a hardship on most MNCs.²²

Finally, it is my conjecture that the recent build-up of undistributed earnings since the 2005 tax holiday is at least, in part, driven by the expectation of a potential future tax holiday. Thus, taxing undistributed earnings at any rate lower than 5.25% would seem to provide a windfall benefit to firms that have shifted income out of the U.S. in anticipation of such a holiday. That is, it is difficult to argue that much of this shifted income would have never been repatriated under the current system.

My view is that our current system of international taxation can be adequately reformed. We need not entirely abandon our current system in favor a fundamentally different system. Limiting deferral and lowering the statutory tax rate would generally reduce incentives to shift income, eliminate the implicit costs of avoiding repatriation, reduce complexity and uncertainty, be easier to enforce and administer, and lower the overall burden of the tax system on U.S. MNCs, relative to a territorial tax system that would necessarily feature anti-base erosion measures. That is, pleas for a more competitive tax system can be answered through a careful combination of base broadening and lower rates.

C. Are there other issues to consider when deciding on the path to reform that might not have been considered so far?

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²² Note that the current stock of foreign earnings held abroad is often estimated for tax policy purposes by looking to PRE reported in firms' financial statements. This will underestimate undistributed earnings.

The accounting literature has recently documented a financial reporting cost of repatriation that is at least as significant to many U.S. MNCs as the cash tax cost – the decrease to financial accounting earnings related to the recognition of the residual U.S. tax. Under APB 23, accounting rules permit U.S. MNCs to defer recognition of the U.S. residual tax expense until repatriation, while the foreign income is recognized in accounting earnings immediately. All else equal, this creates a timing difference whereby accounting earnings increase in the period that foreign income is generated, and decrease in the year of repatriation.

Blouin, Krull and Robinson (2012) estimate that repatriations by U.S. MNCs would increase by approximately 17 - 20 percent annually if APB 23 were repealed, while Graham, Hanlon, and Shevlin (2011) survey executives who indicate that the importance of the tax expense recognition for accounting is as important as the cash tax when making repatriation decisions.²³ Either the elimination of deferral or the adoption of a territorial tax system would render APB 23 unnecessary. **Both revenue and rate estimates of various reform options should take into account the potential increase in repatriations attributable to changes in financial reporting costs.**

Adoption of International Financial Reporting Standards (IFRS)

Over 100 countries use IFRS as set by the London-based International Accounting Standards Board and U.S.-listed foreign firms have been allowed to file financial reports with the SEC in IFRS since 2007. Use of a common set of accounting standards in the EU expands the opportunity set of benchmark firms available to MNCs for substantiating tax-advantaged transfer prices. De Simone (2013) finds a positive association between IFRS adoption and income shifting in EU affiliates.²⁴

There is no clear roadmap for adopting IFRS for U.S. firms. This may serve as a constraint on future income shifting out of the U.S. for U.S. MNCs, as the number of benchmark firms is limited to firms reporting under U.S. GAAP. **Any constraints on shifting income posed by the decision not to adopt IFRS in the U.S. should be considered when evaluating the extent of income shifting that might occur under a new tax system.**

Financial reporting disclosures and tax reporting

Financial reporting disclosures may affect firms' tax reporting decisions. Hope, Ma and Thomas (2013) find that firms voluntarily discontinuing disclosure of geographic

²³ Graham, John, Michelle Hanlon, and Terry Shevlin (2011). Real Effects of Accounting Rules: Evidence from Multinational Firms' Investment Location and Profit Repatriation Decisions. *Journal of Accounting Research* 49 (1), 137-185; Blouin, Jennifer, Linda Krull, and Leslie Robinson (2012). Is U.S. Multinational Dividend Repatriation Policy Influenced by Reporting Incentives? *The Accounting Review* 87(5), 1463-1491.

²⁴ De Simone, Lisa (2013). Does a Common Set of Accounting Standards Affect Tax-Motivated Income Shifting for Multinational Firms? Stanford University working paper.

earnings after the implementation of SFAS 131 have lower ETRs than other firms. SFAS 131 relaxed the requirement to reports earnings for geographic segments, and only required disclosure of sales and assets.²⁵ Akamah, Hope and Thomas (2014) find that disclosure aggregation for geographic operations is more prevalent in firms with tax haven subsidiaries. These findings imply that geographic segment data may facilitate the enforcement of transfer pricing rules, consistent with proposed regulations in the EU (OECD 2014).²⁶

Dyrenng, Hoopes, and Wilde (2014) examine a U.K. requirement to disclose the name and location of all subsidiaries. Firms that did not comply with these requirements, but were subsequently forced to do so, exhibit an increase in the accounting ETR and a decrease in tax haven usage relative to firms that were in compliance.²⁷ Gupta, Mills, and Towery (2014) find that mandatory disclosure requirements in the U.S. regarding tax uncertainty increase firms' state income tax expense as well as state income tax collections.²⁸

The association between financial reporting disclosures and tax reporting behavior has two important implications. First, tax policy makers should consider any role of accounting disclosures in evaluating behavioral responses to various reform options. Second, tax disclosure requirements could be considered as additional policy measures to aid in the enforcement of tax policy.

Thank you. I would be happy to answer any questions that you may have.

²⁵ Hope, Ole-Kristian, Mark Ma, and Wayne Thomas (2013). Tax Avoidance and Geographic Earnings Disclosure. *Journal of Accounting and Economics* 56(2), 170-189; Akamah, Herita, Ole-Kristian Hope, and Wayne Thomas (2014). Tax Havens and Disclosure Aggregation. Rotman School of Management working paper 2419573.

²⁶ Discussion Draft on Transfer Pricing Documentation and CBC Reporting. 30 January 2014. <http://www.oecd.org/ctp/transfer-pricing/discussion-draft-transfer-pricing-documentation.pdf>

²⁷ Dyrenng, Scott, Jeff Hoopes, and Jaron Wilde (2014). Real Costs of Subsidiary Disclosure: Evidence from Corporate Tax Behavior. Duke University working paper.

²⁸ Gupta, Sanjay, Lillian Mills, and Erin Towery (2014). The Effect of Mandatory Financial Statement Disclosures of Tax Uncertainty on Tax Reporting and Collections: The Case of FIN 48 and Multistate Tax Avoidance. *The Journal of the American Taxation Association*. doi: <http://dx.doi.org/10.2308/atax-50766>