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# Tax Avoidance and Multinational Firm Behavior

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# Overview

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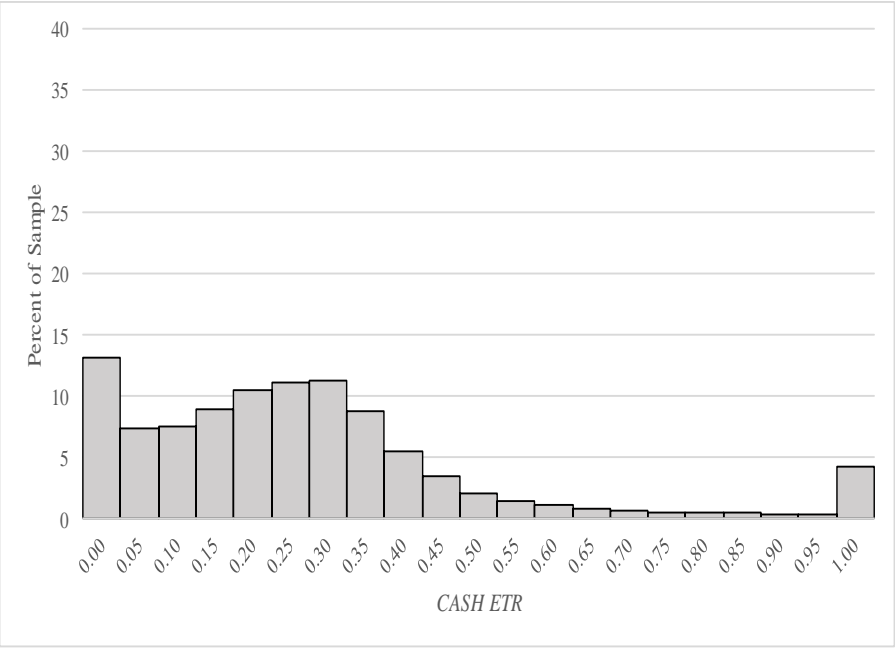
- MNCs pay tax – both income and non-income taxes
- Tax avoidance – 2 types of measures we discuss
  - Effective tax rates – cash and GAAP
  - Income shifting
- Economic consequences?
  - Yes
- Why not avoid all taxes?
  - Must be constraints
- Going forward

# Tax Avoidance and How Successful?

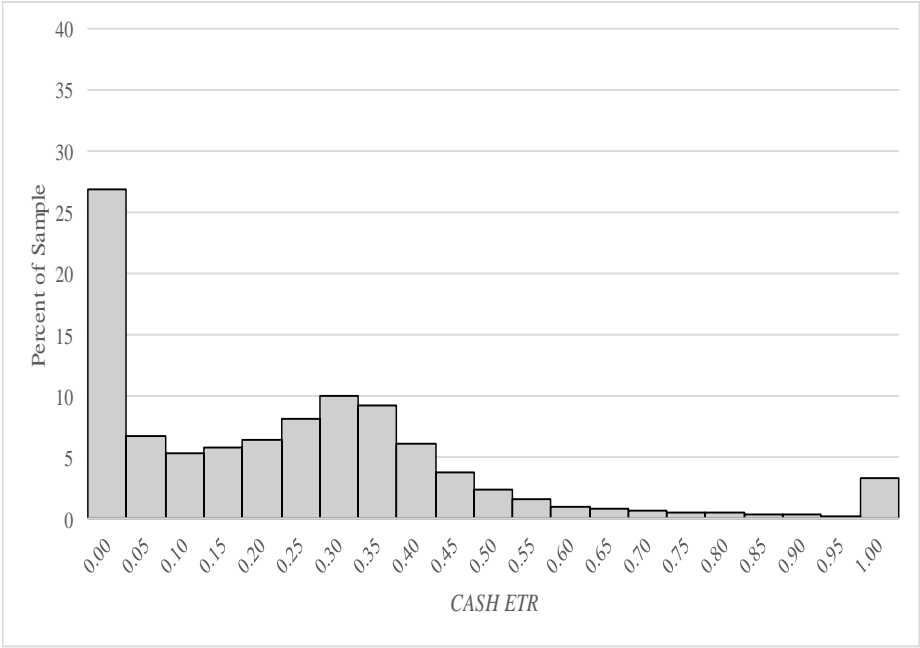
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$$CASH\ ETR = \frac{\sum_t CASH\ TAX\ PAID_t}{\sum_t PRETAX\ INCOME_t}$$

# One-Year Cash ETRs

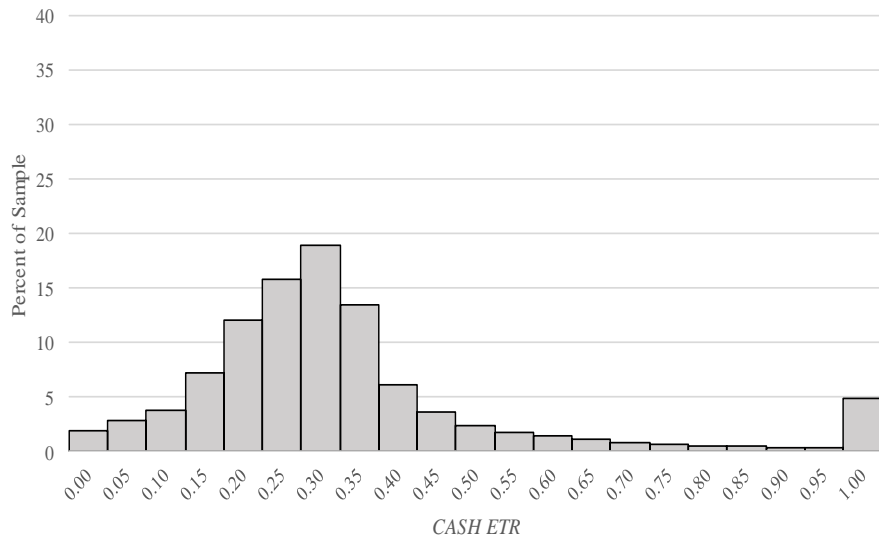


MNCs – 1988-2017

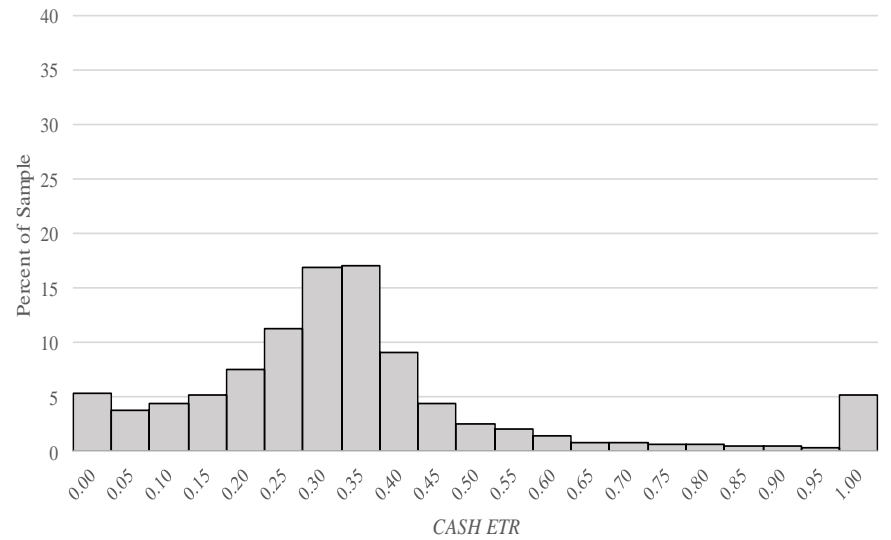


DOCs – 1988-2017

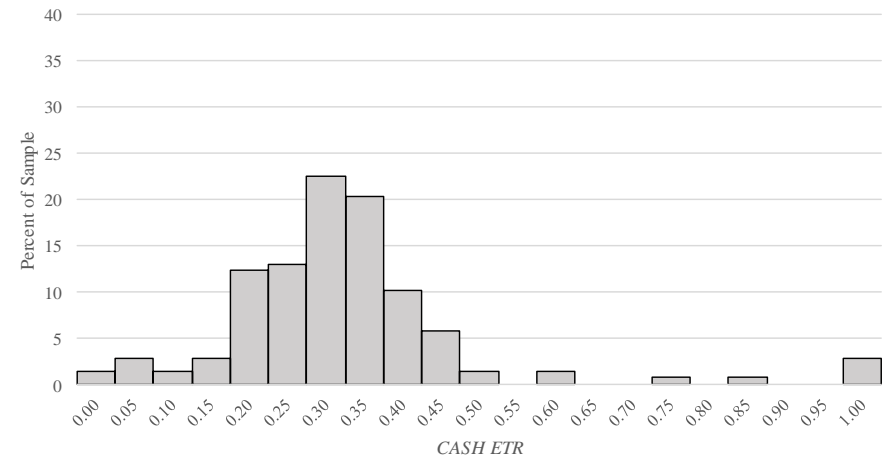
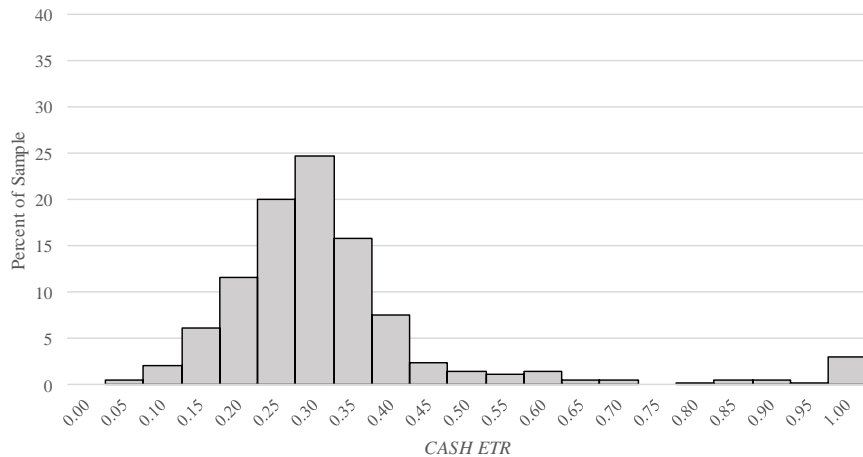
# 10-Year and 30-Year Cash ETRs



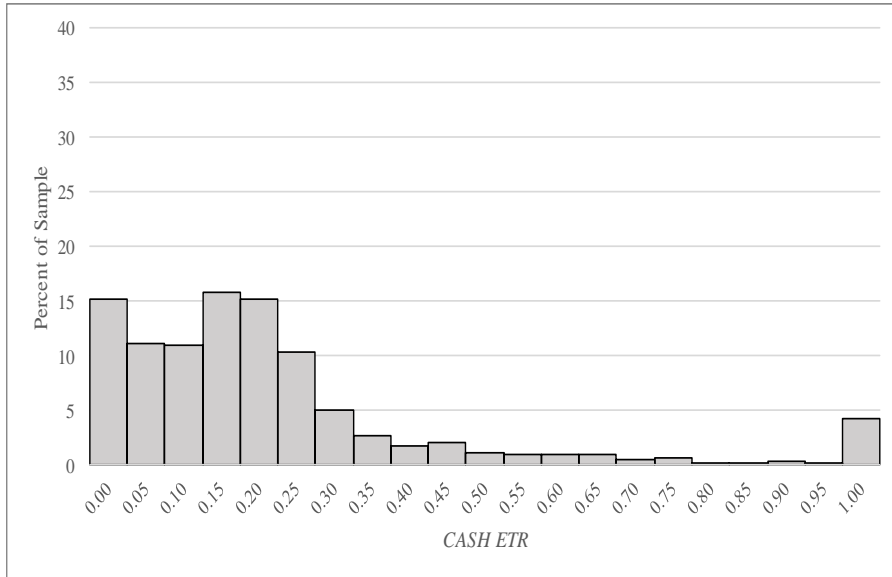
MNCs – 1988-2017



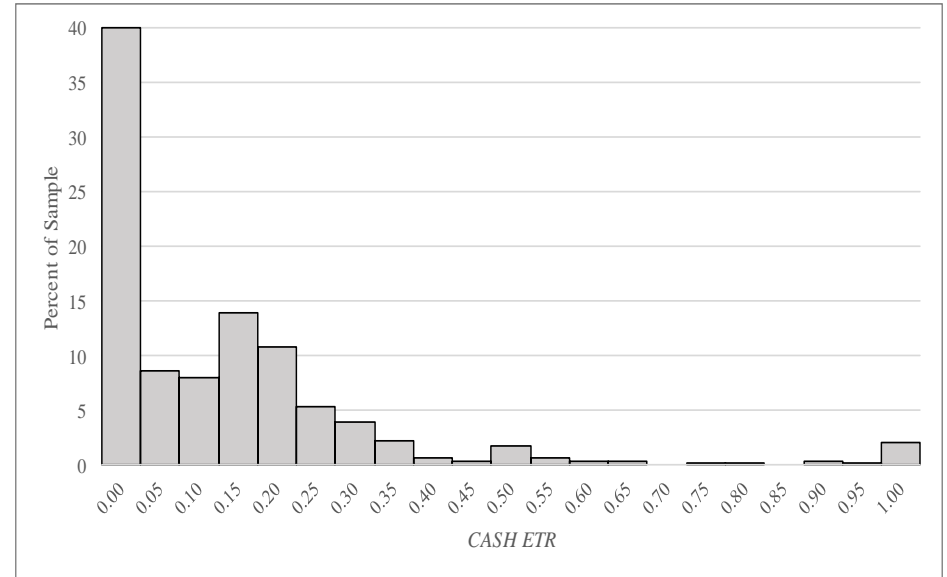
DOCs – 1988-2017



# One-Year Cash ETRs - 2018

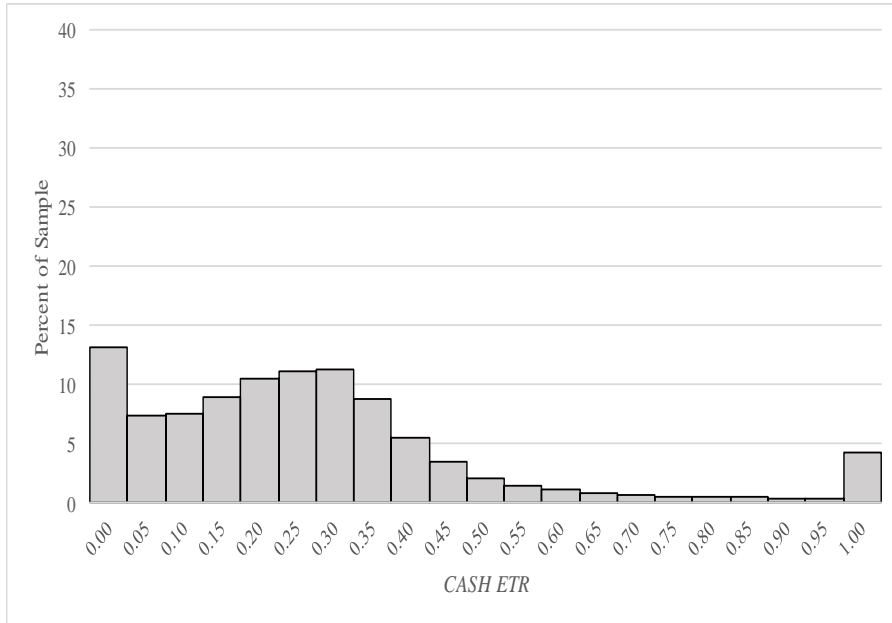


MNCs – 2018

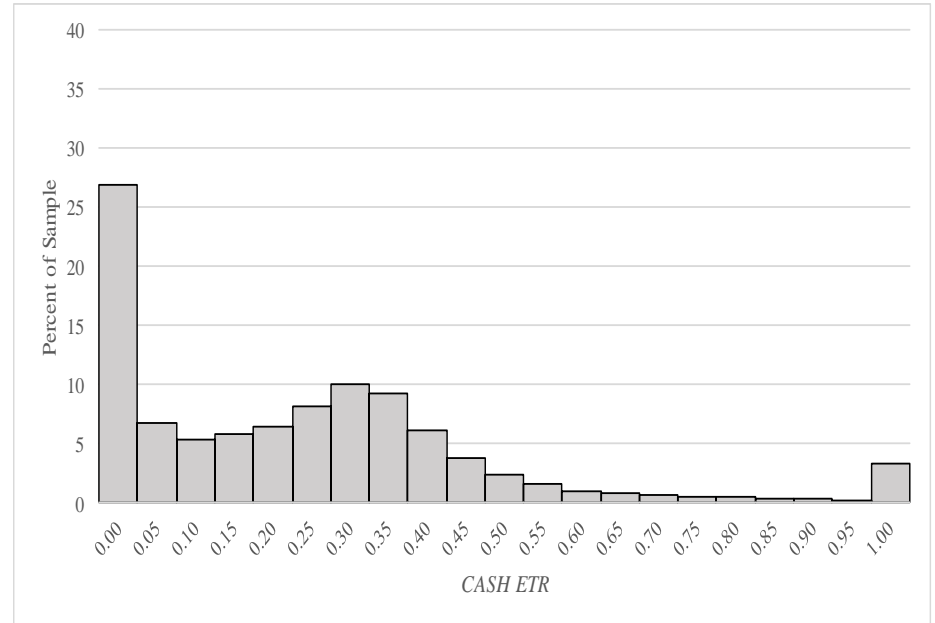


DOCs – 2018

# Recall: One-Year Cash ETRs

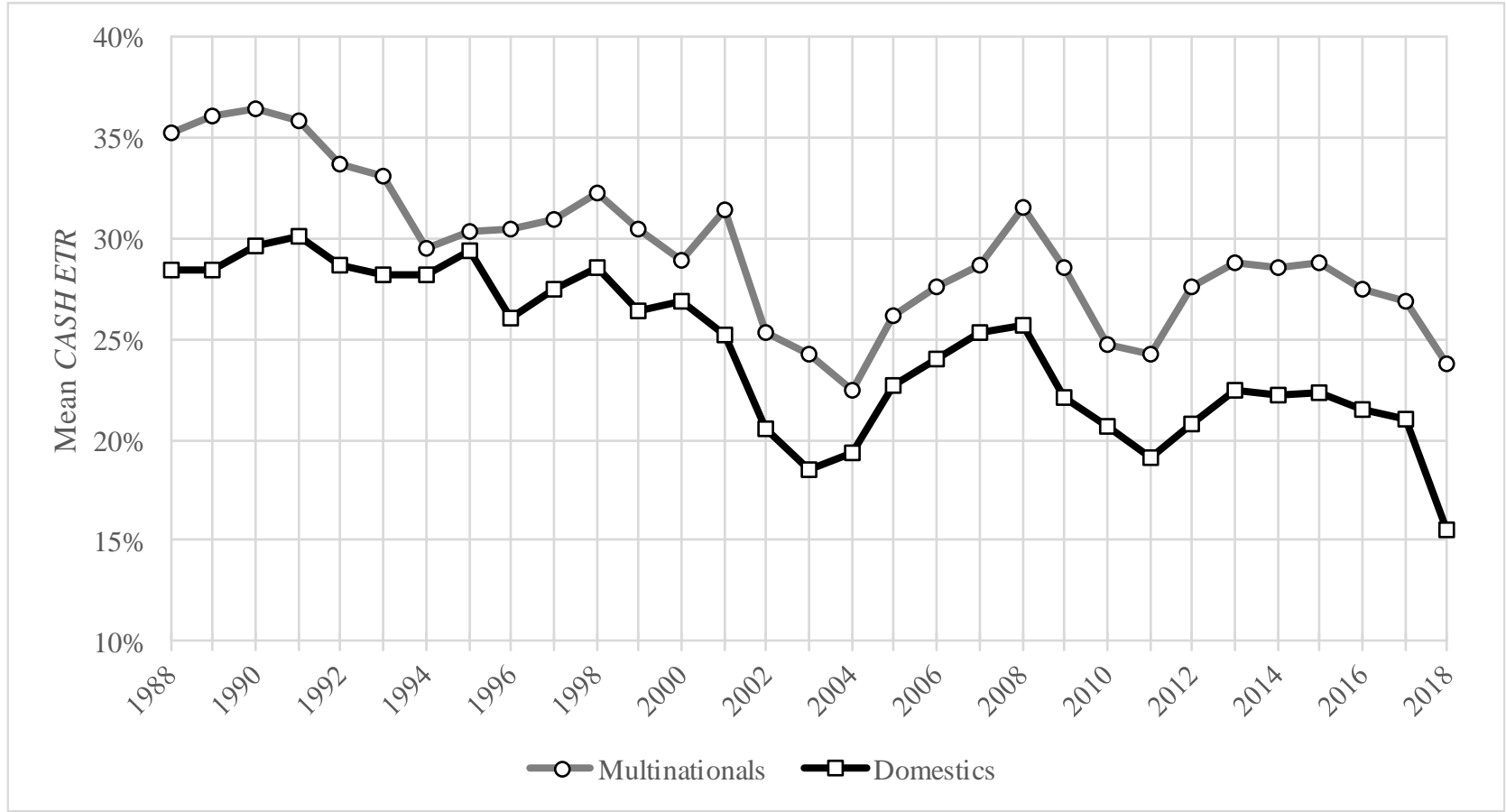


MNCs – 1988-2017



DOCs – 1988-2017

# Trend over Time





# How do MNCs Avoid Tax?

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- One way is to shift income to low tax jurisdictions.
  - Some anecdotes/examples – transfer pricing, move intangibles to tax havens (e.g., Ireland), cost sharing, etc.
  - Many studies on this, using both macro and micro data.
    - Often requires estimates of unshifted income.
      - Compare what companies report relative to some estimate – based on factors of production or location of economic factors (formulary apportionment). Alternatively, examine how reporting changes around a change in tax regime.
    - Also studies that employ shocks to income, examine transactions that involve transfer pricing, compute long-run estimates, and evaluate it over time.

# Income Shifting

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- Not much debate that some amount of income shifting occurs.
- Huge debate on the extent to which it occurs.
  - Some recent estimates seem high given what we know about public MNC's foreign earnings and foreign tax expense.
  - Also, there are questions about appropriate use of BEA data and there have always been concerns about the quality of BVD data.
- Interpretation of what it means.

# How do MNCs Avoid Tax?

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- Choose locations for activities that are tax-advantaged (beyond shifting income):
  - Evidence is consistent with FDI being higher when tax rate is lower.
  - Evidence is consistent with debt being sensitive to tax rates and other tax rules.
  - Some evidence that employment is sensitive to tax rates.
  - Market for corporate control – cross-border deals.

# Consequences of MNC Tax Avoidance

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- Evidence that tax avoidance is associated with:
  - Abnormally high cash holdings/balances.
  - Capital structure distortions – more debt in the U.S.
  - Investment and merger and acquisition activity:
    - U.S. MNCs with large balances of foreign cash are more likely to acquire firms in foreign locations and invest in cap ex in foreign locations than firms with low foreign cash balances.
    - Foreign subsidiaries of U.S. MNCs with large cash balances are more likely to be acquired by a foreign entity than one with a relatively low cash balance.
  - Employment
- Lost government revenue

# What are the Constraints on Tax Avoidance?

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- Must be the case that there are constraints on avoidance in general because MNCs do pay tax and there must be constraints on income shifting because investment is sensitive to tax rates.
- Some constraints:
  - Contrary to rules and/or risk of enforcement
  - Reputation
  - Financial accounting

# Conclusions

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- Evidence of tax avoidance and that tax avoidance varies in the cross-section and over time; but, MNCs do pay substantial amount of tax (income and non-income).
- Evidence of income shifting – income reported in locations different than what would be predicted. Reported income is sensitive to tax rates.
  - Magnitude of the issue is far from settled.
- Going forward: Changing tax regimes and also new pressures on companies – e.g., stakeholder view and international coordination.