



CENTRE FOR TAXATION IN A GLOBAL ECONOMY



SPOTLIGHT ON RESEARCH

by: Ken Klassen

Recent media coverage in the U.K. has brought geographic income shifting by multinational corporations to the attention of the public with specific mentions of Google, Amazon, eBay, and Starbucks. Furthermore, the ongoing and significant work of the OECD has stimulated governments to reconsider their approach to the taxation of these corporations. Yet, absent from the debate is a structured analysis that considers the complex nature of investment in foreign jurisdictions where income shifting is possible. A recent paper, forthcoming in the Journal of the American Taxation Association, by Kenneth Klassen, University of Waterloo, Stacie Laplante, University of Wisconsin, and Carla Carnaghan, University of Lethbridge, begins to address that omission.

The paper, "A model of multinational income shifting and an application to tax planning with e-commerce," explores tax planning in a multi-jurisdictional setting by jointly considering costs of income shifting and the decision to repatriate or reinvest foreign earnings. The model looks at both investments governed by territorial systems and worldwide systems, like the U.S. and Canadian investment in countries without Tax Information Exchange Agreements. It demonstrates that there is an incentive to shift income to parents from high foreign tax rate subsidiaries and to shift out of parents in territorial countries to lower foreign tax rate subsidiaries.

However, it is not always optimal to shift income out of the U.S. to low foreign tax rate subsidiaries. This is a novel and key insight: that the incentives that give rise to cross-border income shifting in the U.S. also affect the incentives to repatriate foreign earnings.

To provide an illustration of the model's predictions, the paper uses differing levels of e-commerce as one source of firms' differing costs of international tax planning. Using e-commerce reduces tax planning costs by allowing companies to shift sales between domestic and foreign locations and by strategically locating sales among foreign jurisdictions. For example, Dell has been in Norwegian and Spanish courts over the last decade trying to defend its practice of sourcing European sales to its websites in Ireland. This paper is the first to use a large sample to examine whether these behaviours are isolated to a few companies or of wider application—something that is important as policy change is contemplated.

To conduct the tests, the paper examines the relation between foreign income and the enterprise's cash effective tax rate: cash tax payments deflated by pretax book income. A negative relation between foreign income and tax payments is consistent with multi-jurisdictional tax planning, because it implies that the proportionately more foreign income a

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» **Tax Policy Research Symposium**

» June 19 and 20

» **Taxation in a Global Economy Research Symposium**

» September 25 and 26, Austin TX

company makes, the less tax it pays. The paper tests whether this negative relation is accentuated for firms that use e-commerce extensively and thus have lower shifting costs. Using more than 5,000 manufacturing company observations over a ten-year period, the results from the tests are consistent with this prediction. For instance, consider firms in the top quarter of foreign income. With the increased use of e-commerce from the average 2001 level to the average 2010 level, the cash effective tax rates of this group fell 1.75 percent on average, compared to firms at the bottom quartile of foreign income.

The insights of this paper are important for policy setters

and tax administrators because they illustrate the commonality of income location incentives stemming from firm taxation and investment characteristics. These insights can strengthen policy analyses. For example, current U.S. policy discussions on territorial and worldwide taxation (affecting repatriation incentives), and on base erosion and income shifting are inherently intertwined. Policies directed at one of these current topics should consider the effects on the others as well. More broadly, tax policies directed at multinational tax behaviour should consider the broader investment incentives, as is done in the model.

CONFERENCE STRESSES STUDENT PREPARATION

by: Jim Barnett

On May 16, 2014 the Centre held its second Tax Educator Conference at the Centre for International Governance Innovation in Waterloo. Attending were 19 faculty members who teach taxation, representing 11 universities from across Ontario. The focus of the event was on effectively preparing students for the CFE and for their careers.

In the morning Maria Loschiavo, Director of CPA Ontario's School of Accountancy, led participants through the CPA Professional Education Program (PEP). It became clear that integration across technical competencies is a major theme of the new program -- and one that each school must address in the design and delivery of courses. In both core courses and electives a significant part of the PEP material requires candidates to address multiple competencies in the same question. For example, one question may involve tax, financial accounting and governance, and candidates must address all three to come up with a comprehensive recommendation.

One of the biggest challenges for tax educators is to develop teaching materials that integrate technical competencies. Participants agreed to follow up with Maria Loschiavo on this matter in the fall.

In the afternoon three speakers from tax practice discussed the knowledge and skills the profession is looking for in graduates when hiring for tax or

non-tax functions. Speakers were Betty Ann Jarrett (PwC - Tax Partner, Global Tax Human Capital Leader, Oakville), Cynthia McIntyre (Ernst & Young - Tax Partner, Business Tax Services, Waterloo) and Stuart Cottrell (Deloitte - Senior Manager, Business Tax Services, London).

Among the things they stressed in outlining what graduates should know and be able to do were these:

- » Critical thinking
- » Judgement
- » Ability to learn
- » Teamwork
- » Understanding business structures
- » Integration of tax with financial accounting.

It seemed that many of the enabling and technical competencies that professionals are looking for are part of the PEP and therefore should be part of university programs. It was not surprising that soft skills were viewed as so important.

While we were pleased to have coverage this year from virtually all the Ontario universities, next year we would like to attract tax faculty from across Canada to get an even broader perspective.

Thanks to Ernst & Young for sponsoring the lunch.