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# **Discussion of Klassen and Laplante “Cross-Jurisdictional Income Shifting: A Multi-Year Approach”**

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Linda Krull  
University of Oregon  
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# Contributions

- Multi-year approach to income shifting
- Model of income shifting incentives
- Incorporate investment and financial reporting incentives into income shifting setting
  - Current working papers in the area: Graham, Hanlon, and Shevlin (2009), Blouin, Krull, and Robinson (2009)

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# Multi-Year Approach

- Motivated by:
  - Income shifting plans not easily adjusted due to transactions costs
  - Changes in earnings patterns can be red flags
  - FTCs can be carried back and forward

$$\text{FRoS} = \beta_0 + \beta_1 \text{RoS} + \beta_2 \text{HighFTR} + \beta_3 \text{LowFTR} * \text{FTR} \\ + \beta_4 \text{HighFTR} * \text{FTR} + \sum \beta_{5k} \text{IND} = \sum \beta_6 \text{YEAR} + \varepsilon$$

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# Multi-Year Approach: Table 4

	(A)	(B)	(C)	(D)	(E)	(F)
LowFTR* FTR	0.036 (2.11)	0.018 (1.55)	0.042 (2.21)	0.008 (0.35)		
Mean LowFTR* FTR					-0.033 (-0.80)	-0.088 (-1.93)
HighFTR* FTR	-0.107 (-18.11)	-0.106 (-13.37)	-0.108 (-10.91)	-0.101 (-8.57)		
Mean HighFTR* FTR					-0.120 (-3.88)	-0.095 (-3.29)
Diff.	0.14***	0.12***	0.15***	0.19***	0.087*	0.007

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# Model of Income Shifting

- $1 + (R_f - S)(1 - t_f) + S(1 - t_d) = 1 + r_f - s_f + s_d$
- $(1 + r_f - s_f)(1 + r_f - s_f + s_d) + s_d(1 + r_d)$

S can be positive or negative, which I believe represents shifting income in versus out.

They use this to develop after-tax value for  $t_f > t_d$

Then for  $t_f < t_d$

But in this case, a piece may be missing,  
i.e.  $1 + (R_d - S)(1 - t_d) + S(1 - t_f)$

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# Investment Incentives

- Foreign pretax income used for DV and IV
    - $DV = \text{foreign pretax income} / \text{foreign sales}$
    - FIO defined using foreign pretax income minus tax expense divided by sales.
    - Sensitivity test uses cash balances and operating cash flows
    - Perhaps try growth in foreign sales
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# Financial Reporting Incentives

- Hypothesis 4: When foreign tax rates are less than domestic tax rates, U.S. multinational companies shift income out of the U.S. if they have a financial reporting incentive to do so.
  - $FRI=1$  if tax on PRE is disclosed or if not practical to estimate
  - This hypothesis can hold for shifting income in as well.
    - Income shifting behavior observed is the average over high and low tax subsidiaries.
    - If financial reporting incentives then shift more income out to low tax subsidiaries and on average shifting less in.
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# AJCA

- Tax rate on repatriations decreases in 2004 or 2005
  - May affect decision to shift income out
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# Summary

- I like the paper
  - There are some improvements that can be made in terms of the theory and empirical tests.
  - I look forward to seeing the next draft.
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