# *Understanding the interaction of motivation and opportunity for tax planning inside US multinationals: a qualitative study*

# UNDERSTANDING THE INTERACTION OF MOTIVATION AND OPPORTUNITY FOR TAX PLANNING INSIDE US MULTINATIONALS: A QUALITATIVE STUDY


## ABSTRACT

We explore the internal workings of tax planning within US multinational enterprises (MNEs) using a qualitative research method. We conduct a series of interviews with senior tax executives, supplemented with other public information. We find that US MNEs adopt a heterogenous range of approaches driven by the motivations as well as the opportunities to reduce their tax bill legally. We develop a new theoretical framework that analyses the interactions of motivations and opportunities in MNEs' tax planning strategy. We generate four typologies of corporate tax payers. Our study provides new insights detailing why and how companies plan their tax.



**Key words**: US MNE corporate tax planning; UK subsidiary operations; international taxation; interviews; qualitative methods.

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## INTRODUCTION

Corporation tax has become a focus of interest for governments, the public and international bodies over recent years. Tax avoidance activities by multinational enterprises (MNEs) have been hitting the headlines, particularly since the global financial crisis of 2008 when the conduct of the commercial sector came under increased scrutiny. Since the financial crisis governments have also been under pressure to increase their fiscal revenues to fund public spending which has generated increased interest in corporate tax avoidance activities. This greater scrutiny has revealed that 'tax planning'(see Literature Review for definition), has a significant impact on the way that MNEs structure their businesses and implement their overall strategy. It is therefore vital that scholars of international business (IB) scrutinise the way that tax planning is conducted across MNEs and are conscious of the impact it can have on overall corporate strategy.

When MNEs formulate and implement their business strategy corporation tax is among the key factors considered, influencing decisions on the location of foreign direct investments (FDI), the amount of capital invested, the locations where profits are recorded, and the choice between retaining profits and holding cash at foreign subsidiaries versus profit repatriation. Tax planning may influence the role of subsidiaries within the corporate group structure and therefore has a wider impact on corporate strategy than simply on tax liability.

MNEs are able to shift their profits between jurisdictions, taking different measures to increase their profits in lower tax jurisdictions and decrease them where taxes are higher, consequently reducing profits in higher tax locations, and therefore the tax payable (Samuelson, 1982; Rugman & Eden, 1985; Zucman, 2014). Tax competition between countries has intensified in recent years as countries compete to attract inward FDI (Devereaux, Lockwood & Redoano, 2008; Altshuler & Grubert, 2006) resulting in lower corporate tax rates. The continued availability of tax havens, combined with the growing tax competition means that MNEs have significant opportunities for MNEs' shifting income from high-tax to low-tax jurisdictions.

Global value chains and corporate structures are becoming more complex, increasing the opportunities for profit shifting (Foss, Mudambi & Murtinu, 2018). UNCTAD has noted this the role that tax has played in driving these structures and a surge in cross border mergers and acquisitions (M&As) ($721 billion in 2015; $432 billion in 2014) (UNCTAD 2016).

Studies have shown that there are substantial differences between firms' effective tax rates (ETRs), defined as the average rate at which a corporation is taxed on pre-tax profits (Dyreng et al, 2008; Blouin, 2014). The existing literature fails to provide an explanation for why some firms appear to engage in aggressive tax avoidance whilst others fail to (Gallemore, Maydew & Thornock, 2014). In their comprehensive overview of the literature, Hanlon & Heitzman (2010) suggest that more research is needed to explore the issue, focusing on: *"Why do some corporations avoid more tax than others"* (Hanlon & Heitzman, 2010). Gallemore et al (2014) agree that: "*the forces that are curtailing more widespread tax avoidance are not well understood."* (Gallemore et al, 2014). A clearer understanding of the factors that drive the differences between firms is needed with a greater focus on the impact of firm level factors and the decision-making processes for tax planning inside MNEs. There is no coherent theory available for researchers to draw on, of why and how MNEs plan their tax affairs.

Our study aims to address these limitations and contributes to the IB literature by enhancing our understanding of this phenomenon. We respond to recent calls for more research that stress the importance of improving our understanding of how tax affects wider corporate activities and strategies of MNEs and their subsidiaries (Nebus, 2016). Our central research questions are:

(i) *How does the motivation to avoid tax fit with the theoretical assumptions of IB's motivation for internationalisation?*

(ii) *What are the motivations that drive MNEs adoption of tax planning strategies?*

(iii) *How do MNEs plan their tax affairs to take advantage of the opportunities available to them?*

We adopt an interdisciplinary approach by integrating IB literature with research from other disciplines but with the intention of explaining the phenomenon from a perspective that is relevant to IB readers. We use a qualitative research method, aiming to reveal how decisions are made within the MNE and what are the key influences on this decision-making in order to generate a specific understanding of what drives the heterogeneity of approaches adopted (Doz, 2011; Birkinshaw, Brannen & Tung, 2011). We also make a clear theoretical contribution, generating a typology of companies and their approaches to tax planning. We explore how existing IB theory, specifically Dunning's work on FDI motivation, can be adapted to generate new theoretical insight into the tax planning strategies adopted by MNEs.

We conduct a series of interviews with experienced tax executives working within the tax departments of MNEs and tax advisory firms. We narrow our focus to their UK and US experience. This is a limitation of this paper and further work is needed to consider whether our findings apply to MNEs from other countries. We supplement and triangulate our data with information collected from other public data sources.

Our study makes three new theoretical and empirical contributions to the literature:

1. Our core theoretical contribution is to develop a new theoretical framework on the typology of MNEs that analyses the interaction between their motivation to avoid tax and the opportunities that are presented to them.

2. We provide new empirical evidence about how US MNEs and their UK subsidiaries plan their tax affairs by presenting the key findings from 15 semi-structured interviews conducted with senior tax executives (11 initial interviews and 4 follow up interviews).
3. Our interdisciplinary research approach of integrating the perspectives of IB literature with other disciplines in our literature synthesis, the discussion of our empirical findings and development of a new typology is original. This approach enables us to provide an in-depth understanding of the heterogeneity of tax planning approaches adopted by MNEs and their subsidiaries.

## LITERATURE SYNTHESIS

The term "tax planning" has recently become widely used and is intended to encompass the broad range of activities undertaken by firms implementing a strategic approach to reducing their tax bill whilst staying within the bounds of what is legally acceptable. The terms "tax planning", "tax avoidance", "profit shifting" and "income shifting" tend to be used interchangeably in the literature. Profit shifting is defined as the allocation of income and expenses between related parties of the same legal entity with the focus to shift profits from higher tax jurisdictions to lower tax jurisdictions so as to reduce tax liability of the whole group.

Our systematic literature review reveals that research on taxation comes from a broad range of fields, including economics, accounting, finance and law as well as IB. The relevant IB literature focuses mainly on the theory of FDI motives (Dunning, 1993) with theory relating to other areas of tax remaining relatively under-developed. Dunning's (1993) theory can be extended to contribute to our understanding of the motivation to avoid tax. The literature from other disciplines generates an understanding of companies' opportunities to avoid tax. This literature is largely empirical, focusing on the ways in which companies are able to profit shift.

It is now widely accepted that tax differentials between countries affect the behaviour of MNEs

(Altshuler & Grubert, 2002; Rego, 2003; Markle & Shackelford, 2009; Hanlon &Heitzman, 2010; Azemar, 2010; Dharmapala & Riedel, 2013; Fuest, Spengel, Finke, Heckemeyer & Nusser, 2013; Taylor, Richardson & Lanis, 2015). Research at the aggregate level has demonstrated that US companies have considerable ability to shift their profits (Grubert & Mutti, 1991; Hines & Rice, 1994; Huizinga & Laeven, 2008), that this ability is increasing (Altshuler, Grubert & Newlon, 2000; Klassen & LaPlante, 2012; Zucman, 2014) and that MNEs are becoming more sensitive to tax rates (Altshuler, Grubert & Newlon, 2000).

MNEs choose to use profit shifting to mitigate the effects of host country statutory tax rates and regulations. A tranche of existing studies consider the existence and magnitude of profit shifting motivated by tax avoidance (Grubert & Mutti, 1991; Hines & Rice, 1994; Huizinga & Laeven, 2008; Azemar 2010; Klassen & LaPlante 2012; Dharmapala & Riedel, 2013; Zucman 2014).

The research cited above uses a range of different methodologies and findings vary but whilst there are methodological problems, stemming from the confidentiality of the data, all determine that there is a significant issue of profit shifting. Examining the MNE from the outside, with limited data means it is difficult to determine how much profit shifting occurs and how this is changing over time. Whilst politicians and policy makers are convinced that there is significant profit shifting, there is no single approach that can confirm this. It is also clear, however, that there is heterogeneity in the way that similar companies, with similar opportunities, plan their tax affairs (Dyreng, 2008). Thus, we need to advance our theoretical understanding of the factors that drive one MNE to take a more aggressive approach to tax planning than another and the consequent implications of this for broader corporate strategy.

### 1.1.The motivation for tax planning

Most IB work examining the motivations of MNEs considers the motivation to internationalise: understanding what drives FDI, where and how investments are made, is key to understanding the behaviour of the MNE. There remains scope for research on broader motivations to add to our understanding of the wider behaviour of the MNE. Benito (2015) argues that understanding motives more widely is important as they are '*useful elements for theory building in international business'* (Benito, 2015). This paper considers the neglected issue of motivation to avoid taxes. As discussed above, there is considerable variation between firms in their engagement with tax planning and little extant work which considers what drives these differences, particularly at the firm level.

Much work on understanding the motivation for FDI has built on Dunning's (1993) classic work presenting four key FDI motivations: market seeking; efficiency seeking; natural resource seeking and (strategic) asset seeking. More recent work on internationalisation however, focuses on 'how' and 'what' questions about FDI rather than focusing on the motivation, the 'why' question (van Tulder, 2015). Van Tulder (2015) argues that a richer understanding of what motivates companies to internationalise, and the tensions and trade-offs that they make between different motives is key to adding depth to scholars' understanding of the actual internationalisation strategies of companies. Understanding why companies have chosen to internationalise in the way that they have is also a necessary component in enabling evaluation of company performance.

Van Tulder (2015) argues that Dunning's key four motivations are all intrinsic to the firm and that their intrinsic nature ensures that they fit within the neo classical approach adopted by many IB theorists. By contrast, the extrinsic motives for internationalisation relate to the home and host country characteristics. Dunning (1993) also includes other, extrinsic, motivations for FDI that have often been overlooked in subsequent work. These include: escape investments, support investments and passive investments. Escape investments include those where the MNE's overseas investment is initiated in order to escape negative conditions in the home country, such as high levels of corporate taxes or other, stringent regulations such as those pertaining to the environment or labour. Studies (van Tulder, 2015; Cuervo-Cazurra, Narula & Un, 2015; Cuervo-Cazurra & Narula, 2015) have pointed out the unwarranted neglect of these wider motivations and the need for further research to increase our understanding. This paper makes a theoretical contribution by considering the concept of tax avoidance as an extrinsic 'escape' motive and explores the extent to which MNEs are indeed motivated to invest overseas to reduce their home tax burden.

This adds to our understanding of the extent to which MNEs are motivated by 'escape' and the interaction between this and other motivations. We argue, however, that the motivation to avoid tax is not synonymous with the motive to internationalise. Whilst the two are often inextricably linked, this paper argues that the motive to avoid taxes is a separate, clearly defined motive. Whilst the desire to 'escape' from high domestic taxes *may* lead a firm to internationalise, in reality the two processes are likely to exist separately. Dunning's (1993) four key motives define the key reasons underpinning a firm's motivation to internationalise. The firm may want to avoid taxes as well as internationalise but these motivations are likely to be distinct. The fact that a firm has existing international operations, rather than motivating the firm, provides it with greater opportunities to avoid tax. A firm which has extensive international operations may use these to implement a profit shifting strategy. Equally, a firm which already has extensive international operations may find setting up an additional tax haven subsidiary less of an impediment than a firm which has little experience of international operations. We argue that a firm may be motivated to avoid tax but that this is unlikely to initiate an internationalisation process; a firm which is already internationalised, however, will have greater opportunities and the skills or knowledge required to instigate a tax avoidance strategy.

In order to trigger the extrinsic ‘escape’ motive, companies must have an alternative, a location that offers lower taxes or less stringent regulations for example. Location-specific advantages (LAs) are the advantages offered by countries, making them attractive to the MNE as a place to do business. It is now widely accepted that tax differentials between countries affect the behaviour of MNEs, with lower taxes generating higher FDI (Markle & Shackelford, 2009; Hanlon & Heitzman, 2010; Dharmapala & Riedel, 2013; Fuest, Spengel, Finke, Heckemeyer & Nusser, 2013; Taylor, Richardson & Lanis, 2015). Rugman & Eden (1985) point to the advantage generated by the MNE’s ability to benefit from differences in factor input prices in different locations, from differences in government regulations and from differences in statutory corporate income tax rates (Rugman & Eden, 1985).

Whilst the studies above contribute to an understanding of what motivates MNEs to adopt tax planning, they do not amount to a general theory of motivation which is needed to generate a comprehensive view of how corporation tax fits within MNEs’ strategic direction. A summary of literature that is directly or indirectly related to tax planning motivation is presented in Table 1. Our work extends Dunning’s (1993) work which focuses on motivation and FDI, by focusing our lens on motivation to avoid tax.

**Table 1**

### 1.1.1. Existing research on factors affecting motivation

Table 1 summarises the existing research on factors that may drive a firm’s motivation under the headings of Reputation, Management and Leadership and Heterogeneity. This section therefore

Research demonstrates that firms may be reluctant to engage in tax avoidance due to concerns about the impact it may have on their reputation (Desai & Dharmapala, 2006; Hanlon &Slemrod, 2009; Chen, Huang, Li & Stanfield, 2012; Graham, Hanlon, Shevlin & Shroff, 2014). Extant research varies in terms of whether it assumes that the reputational cost impacts the firm level (Hanlon & Slemrod, 2009) or individual level (Crocker & Slemrod, 2005; Desai & Dharmapala, 2006). At the firm level Hanlon & Slemrod (2009) find that share prices are negatively impacted by revelations of tax avoiding activity. Gallemore et al (2014) confirm this finding but find that the negative impact is short lived, with share prices systematically returning to the level they were at before the tax avoidance revelations. Interestingly Austin & Wilson (2017) consider firms with different levels of 'customer orientation' to test their hypothesis that firms with a greater customer orientation are likely to suffer more reputational harm. They find no difference between the cash taxes paid but find that consumer-oriented firms do consistently report high ETRs; a clear indication that the impact of reputation in driving tax planning behaviour affects different types of firms to a greater or lesser extent. This also demonstrates firms' ability to present their taxes as reported in the annual reports in a planned manner.

A second stream of research has considered the impact of tax avoidance on reputation at the individual – largely Chief Executive Officer (CEO) level. Gallemore, Maydew & Thornock (2014) however, examine CEO turnover rates and find that there is little evidence of impact on CEOs after tax avoidance activity has been revealed. Chyz & Gaertner (2018) consider the role that reputation plays in tax avoidance they hypothesise that if concerns about reputational damage impact behaviour then CEOs would undergo more forced turnover when their ETRs are low. They find the converse: that CEOs' contracts are more likely to be terminated when their firm pays higher taxes as they represent a transfer of wealth to government and from the shareholders. They also, however, find that CEO forced turnover is higher when firms pay a higher rate of tax compared to their peers. They find that the relationship may differ when there is a high level of regulatory interest in tax avoidance such that there is a relationship between CEO termination and low ETRs but only in periods of time when there is a high level of regulatory interest in tax avoidance. Clearly the relationship is complex and more research is needed to clarify the role of reputation in driving motivation for tax avoidance and to explore whether reputation impacts at the firm or individual level.

**1.2.Opportunities for tax planning**

There is a large body of empirical literature, largely from outside the field of IB that tends to be concerned with either evaluating the scale of existing profit shifting or attempting to understand the use of specific mechanisms to reduce tax legally. Most of this work does not aim to understand the differences between companies, treating the MNEs as if they were homogenous. Some work does attempt to evaluate the impact of factors, such as size (Zimmerman, 1985, Gupta & Newberry, 1997, Rego, 2003, Taylor, Lanis & Richardson, 2015) or the degree of multinationality of the firm (Grubert & Mutti, 1991; Rego, 2003; Dyreng & Lyndsey, 2009; Taylor, Lanis & Richardson, 2015). We now consider what is currently known about how MNEs are able to plan their tax affairs, what aspects of their structure or business confer greater opportunities to avoid tax.

Research at the aggregate level has demonstrated that US companies have considerable ability to shift their profits (Grubert & Mutti, 1992; Hines & Rice, 1994; Huizinga & Laeven, 2008) and that this ability is growing (Klassen & LaPlante, 2012; Zucman, 2014) with MNE actions becoming more sensitive to tax rates (Altshuler, Grubert & Newlon, 2000).

There are a number of key mechanisms used by MNEs to shift their profits from higher tax jurisdictions to lower tax jurisdictions or even to tax havens, defined as jurisdictions that offer the MNE a lower tax rate or no tax, so that the MNE can locate some of its business activities there and thus reduce overall tax payments (Rugman & Collinson, 2012). We briefly survey the literature on key mechanisms below in order to set the context for our research. The ability to take advantage of these mechanisms confers the opportunity to avoid tax on the MNE.  Key mechanisms include: location of doing business; the use of transfer pricing in related party transactions; the use of intangible assets and the concurrent use of royalties; capital structure and the use of internal debt; profit repatriation (dividend payment) versus cash holding; using losses carried forward. Our review clearly demonstrates that the way in which these opportunities may present themselves varies between businesses, driving a heterogeneity of opportunities.

Companies' attitudes to risk taking is also a factor in how they view the opportunities that are available to them and whether they are likely to pursue a more aggressive tax planning agenda. Langenmayer & Lester (2018) consider the effect of tax rates on firms' decisions to undertake risky investment. They find that the statutory tax rate in a country has a positive effect on risk taking for firms that expect to use losses in the future, and a weaker effect for those that do not plan to use losses in the future. Whilst this research is not focused on tax avoidance per se, it clearly demonstrates the impact that the company's attitude to risk taking has on its activities and their consideration of strategic issues, including the statutory rate of tax when deciding whether to undergo risky activities.

### 1.2.1. Location

One of the simplest ways for MNEs to reduce their effective tax rate (ETR), (defined as a measure of tax charged as the numerator with a measure of income as the denominator), is to consider the locations where they operate. MNEs can consider the host country tax rates and regulations when choosing where to base operations. Research confirms a negative relationship between the statutory rate and investment (Devereux & Griffiths, 2003; De Mooij & Ederveen, 2006; Azemar, 2010). The interaction of the host and home country tax systems is key because MNEs want to ensure that their overall pattern of international ownership is efficient (Barrios, Huizinga, Laeven, & Nicodeme, 2012). Some MNEs may have greater freedom when deciding on the location of overseas operations depending on the LAs that they need to take advantage of. Dyreng & Maydew (2012) find that firms with more extensive operations in countries with a ‘weak rule of law’ and tax havens engage in more earnings management than companies with subsidiaries in countries where the ‘rule of law is stronger’.

Barrios et al (2012) find that the location decisions for highly profitable subsidiaries are less responsive to tax inducements than for less profitable subsidiaries. This leads them to speculate that high profitability could be location specific, such that moving the subsidiary could reduce profitability. Location decisions of foreign subsidiaries with low fixed assets are more sensitive to parent and host country taxation reflecting the fact that they are simpler to physically move than those with higher levels of fixed assets. MNEs operating with more profitable location specific subsidiaries, or those with high levels of fixed assets may have the opportunity to choose to locate their operations in low tax jurisdictions.

Some MNEs may choose to enter into a M&A with the specific aim of “inverting” the ownership structure such that the newly acquired subsidiary becomes the parent company. Inversions have been politically controversial in the US in recent years with companies that choose to invert subject to criticism. The regulations on allowable inversions have also been tightened. This may affect the ability of some companies to choose this course of action.

The use of tax havens by MNEs has been well documented in the literature (Hines & Rice, 1994; Shaxson, 2011; Jones & Temouri, 2016; Jones, Temouri & Cobham 2018). Tax havens are characterised by having very low or zero rates of corporation tax and have high levels of secrecy that make them attractive to MNEs (Shaxson, 2011; Zucman, 2015). It is hard to define exactly what constitutes a tax haven so researchers have used different definitions to limit the scope of their work. What is of interest here, is not that MNEs use tax havens, but an understanding of the underlying factors that generate the potential for MNEs to take advantage of them as an opportunity to avoid tax. Hines & Rice (1994) split tax havens into “dot tax havens", essentially small island economies and the "Big 7" (Hong Kong, Ireland, Lebanon, Liberia, Panama, Singapore and Switzerland). These have low rates of taxation but have larger markets that may also be attractive to overseas companies. By considering only "dot tax havens", researchers are able to focus on those where there are fewer additional motivations to invest. Desai, Foley & Hines (2006) find that nearly 60 per cent of US companies with substantial foreign operations had at least one subsidiary in a tax haven country.

It is often assumed that all international companies are able to structure their international operations to take advantage of tax havens. Jones & Temouri (2016), however, investigate the drivers for tax haven usage and conclude that technology intensive manufacturing MNEs and service industry MNEs, that is, those with high levels of intangible assets are more likely to own tax haven subsidiaries.

### 1.2.2. Transfer pricing

Transfer prices (TP) are the prices used for the flow of intermediate or finished goods or services between affiliates of the same firm. They are known as related party transactions (e.g. intra-firm trade, intra-firm loans, royalty charges and management fees, etc.). Tax is an issue when transfers are made between affiliates in different locations when these are located in different jurisdictions. OECD guidelines state that related party transactions should be accounted for as if they were "arm's length" transactions with a third party (OECD 2010). This relies on the existence of an external market to provide reference prices. If no such market exists, which may be the case particularly for transfers of intermediate or knowledge based goods or services, it can be difficult to assess whether the prices used are indeed "arm's length prices" (Rugman, 1980; Rugman & Eden, 1985).

Although it is hard to ascertain the extent to which MNEs manipulate transfer prices, there is evidence (Eden, Valdez & Li, 2005) that companies are able to manipulate prices effectively to shift corporate profits to lower tax jurisdictions. Clausing (2003) finds evidence for profit shifting using TP and finds that TP used for intra firm transfers of knowledge or services are more acutely sensitive to the tax differentials between countries.

Some companies may have longer value chains offering greater scope to use TP manipulation to shift profits. TP manipulation is defined as the deliberate setting of the TP paid by one party to another within the same group for the purpose of reducing the aggregate tax burden of the company and its affiliates. This can be done through overcharging (undercharging) affiliates in high (low) tax locations for intermediate goods or the use of intellectual property, consequently reducing (increasing) profits, and therefore the tax payable in high tax regimes (Samuelson, 1982; Rugman & Eden, 1985; Zucman, 2014).

Others may use TP to price the movement of goods or services which are particularly opaque, making it more difficult for authorities to judge the accuracy or relevance of the TP in use. These companies may therefore have more scope to use TP manipulation to shift profits. Research that focuses on TP specifically is difficult to conduct due to the confidentiality of information but could make a significant contribution to the understanding of how companies are able to strategically plan their taxes.

### 1.2.3. Intangible assets, royalties and overheads

Intangible assets are an increasingly important source of competitiveness (Lipsey, 2007). The ownership of intangible assets or intellectual property (IP) can easily be shifted between locations, and their public good nature means that they can be used by more than one subsidiary at a time. Royalty payments charged on the use of intangible assets are considered a tax-deductible expense in the host country and as additional (taxable) income in the home country (Grubert, 2003). The opaque nature of IP means that it is hard find an applicable arm’s length price with which to compare it making it difficult to judge the “correct” price that a MNE should charge (Gravelle, 2008). IP is often unique and is likely to have no functioning market to generate comparable prices (Dyreng, Hanlon & Maydew, 2008; Shackelford, Slemrod & Sallee, 2011). Companies with competitive advantage generated through the use of intangible assets may therefore have more opportunity to profit shift with impunity (Grubert & Mutti, 2007; Dischinger & Riedel 2011).

Some centrally incurred overhead costs may also be re-charged out to subsidiaries and there is likely to be some discretion available to the company in the way that it calculates the apportionment of these overheads as “management fees”, etc. (Contractor, 2016). The opportunities here are likely to be relatively small in scale but the lack of agreed mechanism for doing this may require careful consideration in tax planning on the part of the MNE and its subsidiaries (Altshuler, Shay & Toder, 2015).

It is noted that a number of jurisdictions’ tax laws have no longer allowed management fees as a tax deductible expense. OECD released new guidance on transfer pricing for low-value adding intra-group services under BEPS Actions 8-10 (Ernst & Young, 2015). A number of tax authorities have raised concerns that MNEs may attempt to re-categorize management fees as “service fees” in order to obtain tax deductibility for otherwise non-tax deductible charges. Examples of service charges are IT costs, R&D and engineering support services, services of shared service centres, etc. Because these services are intangible in nature they are subject to withholding taxes in these jurisdictions. A functional profile based benefit test with detailed supporting documentation and data retention is likely to be a key starting point for the tax authorities in their review.

### 1.2.4. Companies with digital delivery of services

Companies operating with the digital delivery of services may be a special case as their flexibility in operations – their ability to locate remotely from the customer - means that they have substantial opportunities to strategically plan their corporation taxes. Companies such as Facebook and Google are able to choose where to locate their headquarters or regional headquarters in such a way as to minimise tax. Google was criticised by the UK's Public Accounts Committee (the UK Parliament, House of Commons, 2012) for establishing their regional headquarters in Ireland, where the corporate income tax rate is 12.5 per cent and for the fact that the UK subsidiary, where the corporate tax rate was 20 per cent in 2012, consequently had no authority to sign a deal with a customer, despite employing a significant sales force. This demonstrates the impact that tax planning has on the day to day operations and longer term strategy of Google as a business.

### 1.2.5. Internal debt and capital structure

Debt can also be used as a mechanism to reduce corporate taxation. Interest expense is a tax-deductible liability, as it reduces the taxable profits of the firm. Intra-firm borrowing (internal debt) and lending can therefore be used to shift profits from high to low tax countries: an affiliate in a high tax country borrows money from and pays interest to an affiliate in a low tax country. The OECD Guidelines (2010) state that the interest payments should be set at a rate which reflects the arm's length rate. The level of risk attached to the loan however, will influence the appropriate rate of interest and may not be easily observed by those outside the firm.

Previous research has identified unusually high levels of debt in high tax countries (Gordon & Lee, 2001; Egger, Eggert, Keuschnigg & Winner, 2010) but no research has been conducted on the firm characteristics that enable this transfer to take place.

### 1.2.6. Losses carried forward

MNEs that have made losses in the past are able to use these to offset against future tax liabilities. This can significantly reduce an MNE's future tax payments. There is however, little published research into this area of tax planning, possibly because losses are not thought to be something that MNEs can manipulate. Companies may however, consider carefully where to accumulate losses in order to maximise their potential for tax planning. Loss making companies are often excluded from research on tax with little explanation for why this is the case (Rego, 2003; Markle & Shackelford, 2009; Dharmapala & Riedel, 2013). Hanlon & Heitzman (2010 p.129) point out that: *"we do not have a very good understanding of loss making firms, the utilization and value of tax-loss carry-forwards and how the existence of losses affects the behaviour …of any of the involved parties"*.

We summarize the literature on key mechanisms used in tax planning in Table 2.

**Table 2 here**

## METHODOLOGY

### 1.3. Rationale of research approach

We aim to extend our knowledge by looking inside the "black box" of tax planning because information about how companies actually plan their tax affairs is scarce (Eberhartinger & Fellner-Rohling, 2012; Feller & Schanz, 2017; Wilson, 1993). Research in this area is hampered by the confidential nature of the subject. Tax is a sensitive issue, with MNEs' tax payments and approach under intense scrutiny. The lack of available data therefore impedes empirical research in this area. Another major problem with the extant tax research is the focus on large scale data, which provides only limited insights into our level of focus: the firm. (Feller & Schanz, 2017).

We use a qualitative methodology as the key research method in our study. A qualitative approach has been used in tax research in the fields of accounting, public finance and policy (Ahrens & Chapman, 2006; Feller & Schanz, 2017; Morrell & Tuck, 2014; Vaivio, 2008). In the same vein, qualitative research is a useful approach for IB research, potentially providing new and in-depth insights to enhance our understanding of a phenomenon. There have been recent calls from within IB (Doz 2011; Birkinshaw, Brannen & Tung, 2011) for greater emphasis on qualitative research methodologies. Qualitative research can, as here, make a key contribution towards the development of theory (Doz, 2011; Eisenhardt, 1989; Yin, 1989, 1994), generating a deeper understanding of what happens within organisations and how that can change over time. Doz (2011) claims that *'Only rich, thick descriptions can provide the basis for the use and possible synthesis of multiple theories into new conceptual development'* (Doz, 2011. p.584). The lack of coherent theory in relation to corporate tax planning indicates that detailed qualitative research has a significant contribution to make in this area.

We start with a broad research objective, implicit and explicit initial *"tentative hypotheses to explain something"* (Miles & Huberman, 1994, p. 147) based on the extant literature. We then refer back and forth to inductively accommodate new findings from our data into a framework with initial hypotheses. As new information emerges, these hypotheses are adjusted accordingly (Greenwood & Suddaby, 2006). We follow the iterative process of theory development, data collection and interpretation. This approached has been adopted in previous tax accounting research (Feller & Schanz, 2017).

### 1.4.Research setting and sampling

Our study covers US MNEs with UK subsidiary operations within a broad range of industries to increase the comparability of our findings on the phenomenon. We also target tax advisory firms due their influential role on the firm-level tax planning (Jones et al., 2018). We aimed to interview people with sufficient seniority and experience to have familiarity with the way in which firms approach the development of their tax planning strategy but to also have a good grasp of technical detail. We decided that these individuals would be qualified accountants but could then be working either in a tax role within industry or within an advisory (tax practice) role.

It was not possible to identify individuals using a typical sampling method due to the difficulty involved in finding willing participants. Expecting a poor response rate, driven by the foreseeable issues of confidentiality, we decided to identify participants through two routes. In the first, more traditional, route, we compiled a list of the largest 100 US companies with UK operations in terms of turnover. We used multiple data sources, including Osiris database by Bureau van Dijk to identify the parent companies and Fame database by Bureau van Dijk to search for their UK subsidiaries. We obtained the names of the parent companies' and the UK subsidiaries' finance directors from Osiris and Fame databases. We also consulted document filings by the subsidiaries with the UK Companies House. We had some concerns that companies who self-selected in this way could result in biased sample in that those responding to an unsolicited letter could have had a positive tax story to tell.

For the second route we identified potential participants through personal networks. Whilst not a traditional method for identifying interview participants we felt that it was justified due to the serious issues of confidentiality. Using personal contacts and recommendations gave the interviewees more confidence that they could speak freely to the interviewer. We ensured that the interviewees identified in this way were similar in terms of seniority as those responding to the invitation letter. None of the interviewees were personally known to the interviewer who is one of the authors of this study. The advantage was that those identified in this manner were more likely to represent a range of opinions and experiences as they had not self-selected. We put a lot of time (approximately six months) and effort in order to secure the interviews.

In total we conducted initial interviews with eleven senior tax executives with extensive experience in corporate tax with an average career span of over 30 years.

After we had generated the typology of MNEs, we tried to return to the original interviewees to conduct a second round of interviews. We were able to secure interviews with just less than half of the original interviewees (four) In total we therefore conducted 15 interviews.

Various research settings may require different numbers of interviews to reach meaningful conclusions (Feller & Schanz, 2017). From our perspective, 15 individual interviews is sufficient; we were confident that we had reached saturation as we found that there was a lack of disagreement between interviewees, and the level of repetition between them seemed to suggest that saturation had been achieved (Suddaby, 2006). The coherence between the interviews and lack of diversity of opinions between the eleven subjects gives confidence that a larger number of interviews would not have been likely to elicit more varied views. Thus, the relatively low number of interviews does not affect the depth of knowledge gained, our analyses and conclusions (Guest, Bunce & Johnson, 2006). All of the interviewees were very well-versed about government tax policies and tax planning practices in both the US and the UK. Table 3 presents some background information about the two rounds of interviews, the participating individuals and their organisations.

**Table 3 here**

For triangulation purposes, we consulted and reviewed archival information of these companies and their subsidiaries from multiple public data sources, including the company websites; the US parent companies' 10-year annual reports/ 10-K filings (2005-2014); the UK subsidiaries' 10-year full accounts filed with the UK Companies House; and business and finance news in the press associated with their businesses.

### 1.5.Data collection

Interviewees were guaranteed confidentiality and were requested to sign a consent form. Whilst the purpose of this form is to protect the interviewee, several did not want to sign it, citing a preference to keep the relationship informal and, in their view, more confidential. This reluctance emphasised the extremely confidential nature of the discussions.

We conducted the interviews using a semi-structured framework with a flexible schedule of questions that was piloted before being used in the recorded interviews.

The first round of were held face to face (except one which was conducted by phone (where a tax adviser was currently working in China) and lasted for more than an hour each time. These were conducted in 2016. The second, follow up set of interviews were held in 2019 in order to return to the same interviewees and explore issues around motivation and opportunity in more detail as well as to update findings following the recent, significant, changes to the US tax system. These follow up interviews were conducted by phone and were generally shorter, lasting for more than thirty minutes each time.

Where possible we recorded the interviews and then transcribed subsequently. This was not possible in two instances where the interviewees objected to a recording being made. In these instances the interviewer took detailed notes during the interview and supplemented with additional notes directly afterwards. The interviewees were guaranteed confidentiality in that whilst their views can be shared their names and organisations cannot. The interviewees clearly felt comfortable with the process and the confidentiality that was guaranteed. This was reflected in their disclosure of substantial details about explicit tax planning schemes as well as the specifics of legal cases that they had been involved in. These disclosures demonstrated the interviewees' acceptance of the confidentiality of the interview. The interviewer's previous experience working in a big four auditing firm may have helped to reduce the interviewees' disquiet.

We gathered information about the interviewees' professional background; their views on public perceptions of tax avoidance; views of government policies; revenue collectors (Her Majesty's Revenue and Customs (HMRC) in the UK and the Inland Revenue Service (IRS) in the US) and international organizations (EU and OECD). We asked all interviewees about their detailed knowledge of motivations and opportunities for tax planning. Within these categories, we ensured that the interviews remained open, to allow the interviewees sufficient scope to discuss their specific views, actions, interactions, involvements and decision making. We also used prompts where necessary to encourage detailed and exhaustive accounts.

We followed Lincoln & Guba (1985) to use a number of techniques to strengthen the trustworthiness of the qualitative research. These included confidentiality of information, triangulation, several iterations of data analysis and constant circling between data and literature.

**1.6.Data analysis**

Our interviews aimed to:

(i) generate new in-depth information on the internal workings of the company - the 'black box' of decision making to provide sufficient detail to enable the development of new theory (Doz, 2011);

(ii) gain insight from senior tax executives into the ways that companies plan tax and how this has changed over recent years. The research also aimed to generate new insights that would improve theoretical understanding of the issues in this area.

The primary objective of the analysis was to inductively build theory based on the detailed findings (Welch, Piekkari, Plakoyiannaki & Paavilainen-Mäntymäki, 2011). As the focus of this study is on the internal workings of tax planning inside the MNE and its subsidiaries it was introduced as such to interviewees, emphasizing our interest in the executives' views, actions, experience and decision-making in tax planning. The theoretical scope of our study was to analyse why and how MNEs plan tax affairs and to identify typologies of corporate tax payers.

We analysed the interviews in a systematic and consistent manner using Nvivo specialist software, which enables specific themes to be identified and subsequently used to code the interview transcripts (Bringer, Johnston and Brackenridge 2004). Due to space constraints, selected uncorrected quotes are reported in the text to support our discussion whereas detailed quotes by themes are presented in Appendix 1.

We carefully re-read the transcripts and listened to the recordings a number of times. When new codes were identified from the data previous transcripts were revisited so that these codes could be used. We then identified key patterns of occurrences and linkages of second order themes (within-case analysis) and those patterns across 15 cases (cross-case analysis) and insights from the analysis.

The importance of both a firm's motivation and the opportunities presented to them to avoid tax emerged as clear determinants of tax planning strategies. The typology presented in Figure 1 emerged as we analysed the findings. Interviewees spoke of different levels of 'aggression' with which MNEs would approach their tax planning strategy and also clearly distinguished between the different types of opportunities available to the different companies that they had worked for.

Finally, we summarized our findings, as shown in the framework in Figure 1.

## KEY FINDINGS

The following sections detail the results of the analysis. We use uncorrected quotations within the text to add support to the discussion or to highlight a particular point. We use the results to develop our key theoretical contribution, a typology of tax planning strategies (Fig 1) which highlights the heterogeneity of approaches and indicates some of the key factors that drive the differences between companies. The "high" or "low" motivations and opportunities are relative notions, depending on the relevant factors and in relative to the motivations and opportunities of other companies. The vertical axis presents the motivations for tax planning and the horizontal axis presents the opportunities for tax planning.

The typology that we present emerged from the interviews. Whilst interviewees did not frame their responses in this way they spoke at length about differences in the opportunities that present to companies and the heterogeneity of responses that companies display. Our initial interviews were focused on understanding this heterogeneity and the differences presented themselves clearly on these two axes. The discussions with interviewees make it clear that a range of factors from within the company affect the motivations and the opportunities to adopt an aggressive tax planning stance. Some companies have more opportunities to avoid taxes by shifting profits to lower tax jurisdictions than others. Interview ees discussed the approaches to tax planning that they have encountered. The view was strongly expressed that companies have the scope to make decisions on the stance that they take. Tax laws and regulations are seen as providing grey areas, within which MNEs have scope for decision-making and strategic planning. Tax planning was seen as a continuum where the risk of damage to reputation and potential fines from HMRC and IRS, are balanced against the potential to save money on tax payments. It was the decisions stemming from this approach that drove much of the discussion in interviews.

We follow Balogun (2003) and Tippmann et al. (2012) to structure the findings and discuss each cell in detail. It is noted that the names of companies that are mentioned in four cells of Figure 1 are for illustration purposes only. Information and data on these companies are drawn from public records, such as the European Parliament, the UK's Parliament, House of Commons Public Accounts Committee, the US Government Hearings on Offshore Profiting Shifting and the US Tax Code, business and finance press and academic literature.  The quotes that are cited in italics presented in each cell come from the companies that we interviewed and their names are anonymous due to confidential reasons.

**Figure 1**

Factors affecting a firm's motivation:

- The importance of reputation to a firm.
- The financial position of the firm
- The individuals leading the firm, their personal ethics and experience
- View of firm's responsibility to their shareholders
- Use of targets, KPIs etc relating to ETR and corporation tax paid

Factors affecting a firm's opportunities to engage in tax avoidance activities:

- The clarity of a firm's economic activity – where and when a sale is made for example, affects the opportunities available to them.
- Corporate size, degree of internationality and the locations where they do business
- Extent to which the firm's business relies on IP and transfer pricing
- Extent of involvement in M&A activity

## 1.7. Aggressive tax avoiders

Companies in the first quadrant are called the *"aggressive tax avoiders"*. They have both motivation and considerable opportunity to avoid tax.

*Opportunities*

The opportunities that they are presented with are likely to stem from having significant operations in the digital sphere or within a highly IP intensive sector such as the pharmaceutical industry. Digital companies may have greater scope to plan their tax affairs by booking sales in a low tax country. Without a physical product it is harder to define exactly where a sale has been made, conferring greater flexibility on these companies. Companies such as those in the pharmaceutical industry are able to shift profits using mechanisms such as royalty or transfer pricing for intra-group transactions and payments. The value that should be attributed to movements within these firms is inherently difficult to observe from outside the firm, giving them scope to manipulate prices to transfer profits between subsidiaries.

Companies such as Amazon, Apple, Google, Facebook or Pfizer among other US firms have been accused of aggressive tax planning and would fit within this quadrant (Dischinger & Riedel, 2010; the European Parliament, 2018a, b; Financial Times, 2016a, b; the US Government, 2013; the UK Parliament, House of Commons, Public Accounts Committee, 2012).

*Motivation*

Other companies that could fit here could include those that have a less direct relationship with the public and may therefore have less concern about any reputational impact from tax avoidance. Companies that are struggling financially or are at an early stage of development may also feel more pressure to avoid tax in order to maintain their annual cash flow.

Interviewees suggested that companies have a responsibility to shareholders to ensure that they paid only a minimum, obligatory, level of tax. The actual level of tax paid was seen as a consequence of choices and strategies implemented by the firm. It was suggested that in the US, companies have a clearer fiduciary duty to maximise returns to shareholders (Friedman, 1970), which could motivate US companies to avoid tax more aggressively than those from other countries. Reputation appears to be an issue with one interviewee highlighting the difference between US and UK attitudes:

*"… if you publish in the paper that Apple has significantly reduced its liability US people are not bothered by that, they applaud that. They don't think that that is a bad thing." (I 10).*

It was suggested that there may be a more nuanced position in the UK with shareholders and the public more comfortable with a broader range of stakeholders (Freeman, 1984; Donaldson & Preston, 1995; Evan & Freeman, 1988; Freeman, Wicks & Parmar, 2004). Others were motivated to reduce their tax but didn't stress the need to balance that with other concerns:

*"Tax is like any other line in your P&L. It is a cost that you have a duty or an obligation to manage as effectively as possible." (I1)*

*"These things are not aggressive these are just things that are allowed for under the rules." (I10)*

Companies consider the locations that they operate in with a view to exploiting differences between locations to reduce their tax bill. Tax advisers interviewed reported that companies are relocating to the UK and are attracted by the favourable tax system, the UK market itself and the access it (currently) offers to the European market remain the dominant drivers. For US businesses, the UK's relatively low tax environment means that little tax planning may be required within UK subsidiaries as the tax paid on UK earnings would simply be offset against

US tax liabilities. The reduction of the US corporation tax rate to 21 per cent in the late December 2017 may impact the way that companies consider tax planning in the UK. One company reported that they do not claim R&D tax credits in the UK, as they are administratively complicated to claim. Whilst they would reduce UK tax liability they would simply result in a greater tax liability in the US. One expert confirmed the lack of incentive to plan taxes for companies deferring repatriation:

*"I think that that is why most of the planning probably comes from the top down because if you can't save the money up at the parent's jurisdiction there is really no point trying to drive down tax in the subsidiary jurisdiction. You would have to go to an awful lot of effort and overall, as an organisation pay the same amount of tax - to a different authority but there is no net saving" (I 7)*

Size appears to be an important driver, particularly for companies with more international subsidiaries which appear to have more opportunities to avoid taxes. They are able to use transfer prices and royalty payments in particular to shift profits to lower or no tax subsidiaries. The use of external advisers which is thought to generate greater awareness of tax avoidance schemes was reported to be complex however (Jones et al., 2018). Some larger companies have greater in-house expertise and therefore relied less on external advisers and those with experience of smaller companies reported that less in-house expertise could increase the use of external consultants.

Interviewees reported that there have been significant changes in the way that external advisers are used. They reported that currently, external advisers do not suggest or generate tax avoidance schemes in the way that they would have done a decade ago:

*"Over the last ten years, certainly years ago we would get approached a lot more about planning schemes – it was quite common and that doesn't happen now." (I 12)*

*"when I say fewer advisors offering schemes – there are none" (I 12)*

Another area where significant change was reported is in the area of motivating staff, particularly in the use of Key Performance Indicators (KPIs). Interviewees agreed that in the past the ETR had been the KPI on which tax departments' performance was judged and that this had the potential to drive aggressive tax planning behaviour. Recent changes in attitudes towards taxation, however, had stimulated changes. There was some disagreement in the initial round of interviews about the extent of movement away from ETR targets. Some companies were reported to consider cash-flow or staying within a budget: *"So if you are judged on whether you stay within your budget then you might not be very aggressive because you might not want to go and spend a lot of money on outside advisors. I can think of some large* *companies that operate that way. I think that that is penny wise, pound-foolish kind of thing." (I 10)*

*"If someone has an ETR as a target, it is for the birds nowadays. There may be some organisations... but the vast majority of them, over 90 % will not have an ETR target. And if they do, they don't know what they are doing. They need to catch up."* (I 6)

Most interviewees reported comparing the ETR with that of competitors or other high profile companies. One interviewee, however, made clear that they would never be concerned with what their competitors reported. Another reported having to reassure the CEO that they were adopting an aggressive enough stance:

*"Now from time to time our CEO will challenge us and say Starbucks is doing this, Amazon this, Apple is doing that, why aren't we doing that? And you know he sees that the tax rate is so low and we say but look that is not without risk and look whose names are in the papers every day about this stuff. We try to balance it." (I 4)*

In the second round of interviews (three years later) there was broad agreement that targets had continued to move away from ETR based targets.

Tax emerges as a key consideration for businesses operating in the UK but not as the dominant driver of company strategy. Tax departments saw themselves as facilitating the efficient implementation of corporate strategy rather than as initiators of strategy. Companies that engage in M&A clearly have wider opportunities for tax planning. One interviewee described the role of tax in the M&A that the company had made recently. The company would identify a target and then tax would become a key part of the planning around how the acquisition should be structured and financed:

*"So the tax piece is always a critical piece as we are looking to do acquisitions but it is maybe second or third on the list. The first is obviously, ok what do we see in this business ... So once we identify a target and we think it makes good business sense then certainly as we get into the diligence then tax ramps right up to the top and we say how do we structure this from a tax perspective." (I4)*

### 1.8.Frustrated tax avoiders

In quadrant 2, companies are highly motivated to avoid tax but have few opportunities. Their motivations may stem from a number of factors such as: their culture and the people leading the company; they may be highly profitable (and hence have more to gain from reducing their ETR) or they could have cash flow problems meaning that a reduction in taxes paid will help them to continue as a going concern. The lack of opportunity may arise because they operate in more traditional bricks and mortar' markets with little use of IP or flows of intermediate goods among subsidiaries located in different countries. If their motivation to avoid tax is strong enough they may find ways to reduce their ETR despite the few opportunities available. These may be tempted to adopt riskier tax planning strategies. They are referred to as the "frustrated tax payers". Starbucks is a traditional 'bricks and mortar' company – it is clear where the customer is when they buy their coffees but they have been alleged to adopt tax avoidance strategies have to find alternative routes for tax avoidance (BBC, 2013; Reuters, 2012). For this reason it would fall within this quadrant although they may be positioned closer to the top left of the quadrant. Whilst they do not have the same opportunities to avoid tax as a digital company they have managed to find opportunities to avoid tax through the way that they have structured their business. For example, the coffee buying for the company is conducted out of Switzerland – whilst no beans are ever transported to Switzerland the subsidiary company that is based there is highly profitable – reportedly buying beans and selling on to subsidiary companies with a 20% mark up (Kleinbard, 2013). They have also created value through their ‘intellectual property’ – their logo and drinks recipes. This IP is held in a low tax country and then subsidiaries are charged for its use – therefore transferring profits to the IP owning subsidiary.

The firms included in this quadrant are difficult to observe. Interviewees suggested that new, more restrictive regulations had been introduced which have reduced the scope for implementing tax avoidance schemes in the UK. They also reported improved efficiency on the part of the UK’s HMRC and the US’s IRS at shutting down schemes and at communicating what is an is not acceptable to companies. A change in attitude and development of a more positive relationship with HMRC was noted. One interviewee in the second set of interviews (interview 12), however, felt that over the previous two years (2016-2018) the relationship with HMRC had started to change and become more adversarial again. The interviewee posited that a lack of resources at HMRC, possibly driven by Brexit may have been the cause of this deterioration.

One mechanism to avoid tax which may be open to some companies, inversion, where the structure of the company changes, moving the MNE’s headquarters away from the US, is clearly attractive to companies looking for mechanisms to reduce the tax liability. This option is becoming more difficult for companies to pursue; interviewees emphasised the regulatory hurdles and difficulty in achieving an inversion.

One company revealed that they felt pressure to invert to reduce their tax liability, but felt that their ability to do so was hampered by their situation: *“US market investors… they know our business, it is like bread and butter to them. They know exactly how we operate” (I 1).* The costs to the company itself and also to the shareholders were cited as reasons for deciding against an inversion.

A company's financial situation could also affect their motive to avoid tax. The impact of the corporate tax bill on cash flow was raised by a number of interviewees. Companies that are struggling financially may be motivated to take a more aggressive stance in order to manage cash flow issues. If cash is needed back in the US for investment or for returning to shareholders as dividends, tax becomes a bigger issue, as the company will need find a tax efficient way to repatriate it. Others want to keep the cash in the UK for investment or other reasons.

*"There are a lot of factors that influence whether their stance is more aggressive or less aggressive and I have seen situations where companies had financial commitments and they had no choice but to be aggressive because they had cash flow needs and so they had no choice because they had to keep the banks happy."* (I 10)

*"It is about cash in the business and that is what all finance directors focus on... What the CFO really has to worry about is the strength of the balance sheet and the cash flow."* (I 8)

*"Tax is the biggest cheque of the year so the timing, the bank arrangements, the absolute amount, which can be dictated about where you have recognised your profits."* (I 8)

There was a shared view that tax planning is justified as it relates to profit that is the reward for entrepreneurial effort. Companies are seen to have discretion over where they allocate at least a proportion of their income and profits. One interviewee described the issue as working out what proportion of the income could be categorised as "mobile" and then deciding where the company would like to allocate it. His view was that it may be more difficult to shift income in some companies than in others, but that there is always scope for some movement (I 9 and 13).

Specific schemes reported by the interviewees relied heavily on the US "Check the box" regulations. Check the box is the US tax regulation, meaning that a US company can choose for the tax authorities to treat subsidiaries as divisions of the same company rather than as separate companies called 'check the box' as it is implemented simply by ticking the box on IRS form 8832. This enables the creation of "hybrid entities" where an MNE subject to corporate income tax in one national jurisdiction qualifies for tax transparent treatment in another resulting in significant tax savings. This is accomplished when a company is organized as a partnership in one jurisdiction and as a corporation in another.

One expert discussed the differences between companies and suggested that some are able to shift profits more easily than others but that there is always scope for companies to shift some profit:

*"My idea of thinking about this is that of my 100 per cent of profit in any given company in whatever their business model is, whatever their profit is, is going to be composed of profit that you can't move - services on the ground, production on the ground, etc. but there will be mobile income, profit which can be moved somewhere else through transfer pricing or other agreement: interest, royalty on IP, credit risk, obsolescence risk, insurance risk, employee work force risk. What can you move? What do you have that creates your profit? What can you carve out through contract and send your money somewhere else through an intercompany agreement. That is what TP is all about." (I 9)*

Debt with related interest expense and IP were cited as prominent parts of mechanisms to increase mobility of income. Booking operating losses in one entity can help with tax efficient repatriation but interviewees suggested that the opportunities available to companies were not always the same, with 'bricks and mortar' companies having to work harder to find ways to shift profits than digital companies.

Transferring IP to low tax jurisdictions to facilitate royalty payments was seen as potentially problematic by some interviewees. When transferred from the US it would have to be valued, incurring a tax charge in the US. Early insight would be needed to make this effective. One interviewee stressed that companies would need long term planning to benefit from this:

*"If you start up a business in the US and on the third day you decide that you have got a lot of money to spend on your tax planning you possibly could be well advised to transfer your intellectual property to the Cayman Islands and pay tax on its value on transferring it out of the US" (I 8 )*

Google transferred ownership of its IP to an overseas subsidiary shortly before it listed in 2004. Global subsidiaries now pay a royalty payment to this overseas subsidiary, effectively shifting profits to it and away from the operational subsidiaries. (I 8)

Interviewees also discussed the complex corporate structures that have companies develop to reduce their domestic tax burden. Whilst complicated and expensive to implement interviewees felt that these could still add value:

*'As soon as I look to bring money back the IRS is going to want to tax it but they will leave you alone generally speaking if it is a foreign company. You can always choose not to do that - you can choose to say - I don't want to leave it alone - I want to bring that money from that entity into the U.S… if you are smart about it and put these different structures in place - that is the benefit that you can get. So where all these companies are doing this - they are saying, this*

*entity I want to bring the income or expense back into the US but they are shells, they are holding companies so we are not really bringing the profits back of the real business into the US we are sort of creating an arbitrage and bringing back only what we want to bring back, for different planning reasons.' (I4)*

*'The profitable entities are actually different entities in the UK group so that is not by accident because it is a way to get our money back to the U.S tax-free. Because since it has got no earnings, …we would say that this entity which is sending money back to the US has no earnings and therefore it is treated as a return of basis or a return of your initial capital which is tax free.' (I4)*

*'And so there are various planning techniques that you can avail yourself of that will allow you to combine those businesses and in the long term extract those businesses from the US in a tax neutral way.' (I 10)*

*'Financing is huge - the number one tax planning tool that people often play with on a regular basis. Second would be IP planning and then it is down into the sophisticated transfer pricing stuff and moving parts of your profits to different jurisdictions.' (I 9)*

*'But you have got losses, I have got profits, I want to access your losses which you can definitely get value for where there is a deferred tax asset or actually saving corporation tax into the future. So you had complicated structures and they always struck me as contrived but I wasn't that close to them. We did them from time to time and I had to sign off on them.' (I 6)*

### 1.9.Responsible tax payers

Companies in quadrant 3 have been labelled as "responsible tax payers". These are companies that may have opportunities to avoid tax but choose not to. This may be for cultural and ethical reasons or it may be for more pragmatic or strategic reasons. Company leaders may consciously choose not to engage in strategic tax planning. These may be companies that are particularly concerned about their reputation because they are high profile and media may be more likely to report on their activities. Similarly, they may operate in a controversial industry, such as the defense sector, depend on government contracts, or work closely with the public sector. High tech companies such as those operating in the defence industry may have significant scope for profit shifting through the use of IP and royalties but reputational concerns may reduce their motivation to take advantage of some potential tax avoidance mechanisms.

Other companies may see ‘responsible’ tax paying as part of their corporate social responsibility (CSR) strategy or may be motivated to improve their reputation by signing up to initiatives such as the Fair Tax Mark. The Fair Tax Mark is a certification scheme in the UK which recognises and certifies companies that: “pay the right amount of corporation tax at the right time and in the right place”. Once awarded the Mark, companies are able to display the Fair Tax logo on their website and publicity material. 50 (mostly smaller) companies have been accredited although larger UK companies such as Lush and SSE have also been accredited.

Companies in this quadrant may have available opportunities to reduce their tax liability but their motivation to do so is not as strong. Companies and those working in them feel pressure to plan tax efficiently but interviewees feel the need to balance this “tax efficiency” with the need to protect the company’s reputation and to behave in a way that is consistent with their personal ethics. Companies were reported to be aware of the changes in government policy at the national and supra national level. Initiatives at the OECD such as the Base Erosion and Profit Shifting (BEPS) project were thought to have had an impact on companies’ attitudes to, and willingness to invest in avoidance schemes.

Interviewees felt that companies have a difficult balancing act. Whilst there are rules that have to be complied with, there is considerable scope for interpretation. Managers have discretion in how they interpret the law; what is acceptable practice and what isn't. This leads them to operate in what Muller and Kolk (2015) describe as *"moral free space"*. Compliance with the law is balanced with meeting the needs of shareholders:

*"So I think that that has become more of a balancing act. In the past it was more, you know, we are beholden to our shareholders and our shareholders alone, sorry if you don't like it, bad luck. But I think that there is an internal debate now in most organisations as opposed to it being a very simple thing - we always do the thing that gives us the lowest tax outcome. I don't think it is as clear as that anymore" (I 7)*

*"We need to maximise our shareholder value, which means keeping costs and tax as low as possible, whereas on the other hand the Revenue would like us to pay loads of tax" (I 7)*

A firm with a clear "non-aggressive" stance on tax explained how they have to balance their stance with ensuring that they are delivering the best returns possible for shareholders (DiMaggio & Powell, 1983):

*"We are utilising the tax law as implemented and that is where the tax department focuses... we don't take that extra scam step...We reduce our taxes as effectively as we can but doing so in a moral way and in being a good corporate citizen." (I 2)*

All of the original interviewees felt that the incidence of tax planning was at relatively low levels and the follow up interviews confirmed that this trend was thought to have continued. The financial crisis of 2008 was described as a turning point, with attitudes to business changing as the public became more critical and hostile to "big business" whilst at the same time governments came under financial pressures to ensure that they were maximising their fiscal budgets. A number of reasons were suggested to be driving the lower incidence of corporation tax avoidance some reducing corporate motivation to avoid tax and others affecting the available opportunities

Whilst interviewees believe that companies are now less aggressive in tax planning, it was unclear whether this reflected a fundamental change in approach. Whilst practices may be changing, some felt that this was due to a tightening of regulations and the greater difficulty in establishing legal tax planning practices, rather than from a fundamental change of attitudes.

Some companies' reputations were thought to be more vulnerable than others to charges of tax avoidance. Companies with direct relationships with the general public as consumers and those with the government or public sector as key clients were particularly averse to bad publicity. Consumer boycotts or bad publicity were seen as potentially doing harm to the business. Those operating in business-to-business segments or with no public profile could be more aggressive. Pragmatism appears to dominate tax planning strategy over any particular ethical stance.

*"There are definitely a couple of [companies in this industry] who in my experience will also be a lot better behaved now…but probably entirely because of the reputational damage that could arise, rather than them thinking it is the right thing to do*". (I 7)

The same expert summed up the importance of both motivation and opportunity:

*"I strongly suspect that there is a genuine trend towards companies doing less and less aggressive tax planning. Partly for reputational reasons and partly because it is just a lot harder than it used to be."* (I 7)

One company had a specific reason for not avoiding tax: *"We are dominated by government contracts ...It is a smart business move to make sure that we are paying the right amount of taxes because with the government customer base that we have, we actually benefit from some of those taxes – they invest back in our business" (I 2).*

### 1.10. Straightforward tax payers

Companies in quadrant 4 are likely to be domestic companies that have few opportunities to avoid tax and little motivation to seek out complex corporate structures to facilitate greater tax avoidance. Like the companies in quadrant 3 they are responsible payers but they may have fewer opportunities to avoid tax. They may be frustrated, recognizing that they are competing against international companies that after-tax planning have a lower ETR which affects their competitiveness but are likely to lobby for greater enforcement of tax regulations on these competitors rather than attempt to reduce their own ETR. The UK retailer John Lewis may fit in this category. As a domestic retailer they have few opportunities to reduce their tax liability but have spoken out about the pressure that they feel from companies such as Amazon. The previous Managing Director of John Lewis, Andy Street, argued that: "you have got less money to invest if you're giving 27% of your profits to the Exchequer than, clearly, if you are domiciled in a tax haven and you've got much more. So they [digital retailers] will out-invest and ultimately out-trade us and that means there will not be the tax base in the UK. So I do think it's an issue [taxing digital retailers] that needs to be examined." (Daily Mail 2012)

Interviewers felt that tax planning was more difficult for domestic companies or those lacking a sufficient overseas network or the knowledge needed to create one. The company's attitude to risk would also play a role in whether it chose to develop and engage in tax avoidance practices. Interviewees also suggested that a change in attitude at some companies was driven by an understanding that they have a responsibility to a wider set of stakeholders other than simply their shareholders

The company's overall attitude to risk was also thought to drive its approach to tax planning with the adoption of aggressive tax avoidance considered as an inherently risky strategy. Whilst attitudes to risk or tax avoidance could change over time this was likely to happen slowly in most instances as people trying to push for change more quickly would be resisted. This risk aversion was felt to permeate across all aspects of the business and was set by individuals at the top of the organisation. Risk aversion in tax was felt to be part of the *"ethos, rather than prescriptive policy" (I 5)*. The top management team of this company has a system for setting *"visions and values"* and these are then systematically devolved down through the group to individual team members.

Almost all interviewees felt that their companies took a conservative attitude towards tax avoidance. The interviewees seemed to feel that their companies took only "sensible", limited tax avoidance measures that any company would. Discussion about the tax planning measures that they implement, however, revealed a wider dispersion. Tax advisers similarly felt that the advice they gave was not overly aggressive and the companies that they were advising adopted relatively conservative stances. Complications arise with complicated or *"flamboyant"* structures that require strong governance to overcome: "*You have got to be very clear that you are in control of that structure – the more it is skewed from the normal business life the tighter your controls need to be on it."* (I 5)

Interviewees suggested a number of drawbacks of tax planning that had to be balanced with the potential tax savings. There was real concern about the potential for damage to a firm's reputation (see next section below). Increased administrative and regulatory burdens were cited as added costs to the firm of implementing complicated tax schemes and structures. Uncertainty also increased as the potential for regulatory change could mean that a scheme that is currently approved becomes illegal in the future which could result in significant costs. Current legal advice that a scheme was legitimate may not stand up in court further into the future.

## DISCUSSION

### Implications for theory

First, a core theoretical contribution of this study is to develop a typology of corporate tax planning: companies vary in the different emphasis they place on tax avoidance, that is, there is significant heterogeneity in the motivation to avoid tax. Some companies have more opportunity to avoid tax than others. The very motivated ones will find mechanisms to reduce their tax liability whatever the opportunity but for some companies developing a tax planning strategy is more straightforward than for others. As tax planning has become an increasingly important phenomenon, and our findings, also help to explain why and how MNEs adopt a particular tax planning strategy. We undertook detailed qualitative work for this study, which makes a vital contribution towards opening the "black box" of the tax planning of the MNE, towards going "Inside the Multinationals" as advocated by Rugman (1981). This is particularly important in a subject like corporation tax where issues of confidentiality and transparency generate difficulties and deficiencies in more traditional forms of data analysis. The qualitative research allows us to develop a new theoretical framework which considers the interactions between motivations and opportunities for tax planning. The MNE's motivations, or the extent to which they choose to avoid tax appears to reflect the long-term assessment of its implications for the future of the company. This highlights the opportunity and ability of MNEs to choose their tax strategy and to determine the aggressiveness with which they pursue tax planning. The theoretical framework also allows us to identify four typologies of corporate tax payers –the aggressive tax avoiders, the frustrated tax payers, the responsible tax payers and the straightforward tax payers – as summarized in Figure 1.

Second, analysing what drives the heterogeneity observed between companies (Dyreng, 2008) is key to generating new understanding about corporate strategy but is also a vital component, contributing to understanding for policy makers in this field. We uncover the heterogeneity of approaches adopted by MNEs. Our detailed analysis reveals a wide range of potential opportunities, mechanisms and measures that can be used to reduce tax legally. The firm makes a decision whether or not to use these methods because they have to consider the balance between tax savings versus the risks of damage to corporate reputation in case of aggressive tax planning is adopted. Not only do our results find important variations in the opportunities for tax planning, they provide some significant insights towards considering which tax planning strategy is more likely to be susceptible to risk moving the strategy towards the boundary of what is acceptable (and hence potentially sustainable) and what is unacceptable (hence viewed with great hostility by local stakeholders). Indeed, the interviewees argue that as public interest has grown in this tax avoidance phenomenon, following the global financial crisis of 2008, MNEs are taking a longer-term approach, more conscious than previously of the potential damage to their corporate reputation. The overall analysis suggests that firms' tax planning aims to optimise rather than minimise their ETRs.

Third, some firms are highly motivated to reduce their taxes and plan strategically; others have different motivation driven by a range of factors which may include a concern for their reputation, an ethical or CSR stance or the sector in which they operate. Whilst international firms in particular have scope for tax planning through profit shifting between tax jurisdictions, domestic companies in particular have fewer opportunities. Further work is needed to analyse the impact that this difference has on domestic competition. There are also potential implications for researchers working on subsidiary management. The role and relationships between head office and subsidiary (Birkinshaw and Hood 1998, Tippman et al 2018) may play a role in the way that tax planning is structured. It is important that this area is considered in future research.

**Implications for practice**

Whilst the focus of this paper is at the firm level it is worth noting that interviewees concluded that the people within the company, the overall management and culture are also important factors that drive the aggressiveness of the tax stance. CFOs, CEOs and the board were all felt to have a role in "setting the overall tone" of the company and its attitude to risk (Dyreng Hanlon & Maydew 2010). Responding to a question about what drives their tax position one interviewee said simply: *"The tone at the top" (I4).* Another replied: *"Culture. The most important thing about [Company name] I would say is our culture and embedded within that is the business ethics associated with that - that is our discriminator." (I2).* Future research is needed to focus on the role of individuals within the firm to understand the differences that appear to emerge between them and to identify the drivers of these differences.

Whilst the focus of this study is not on tax policy per se, there are some clear implications for policy makers and for MNE tax managers. Our findings show the flexibility that MNEs currently experience within the international tax regime given that the differentials in tax rates across countries provide MNEs with vast opportunities for arbitrage. MNEs demonstrate behaviours that enable them to plan their tax liabilities. The background and experiences of key executives involved in setting and managing tax policy within the MNE will have an impact on its overall strategy. The characteristics of the firm will denote the areas where it has greater scope for tax planning. The overall aggressiveness of behaviour that emerges will be a consequence of these two factors and it is clear that many MNEs choose to optimise their ETRs rather than minimise.

There are clear implications for managers of MNEs – both at the headquarters and at the subsidiary level. Management needs to be clear that when they are setting their tax planning strategy they are making a choice with implications not only for the corporation tax paid but also potentially, risks to the business including those of public perception and potential damage to their corporate reputation. Executives should actively manage their tax planning strategy in the light of these potential trade-offs.

Changes to the legislative framework may be needed to address these areas. Tax executives argue that they respond to the legal framework and may feel pressure from within the company or from shareholders to reduce their tax liability if they are out of line with their peers. Tax planning and payments need to become less of a choice and more of an obligation for MNEs. Our study finds that MNEs do not adopt a homogenous approach to tax planning and government policies need to respond to these differences.

**LIMITATIONS AND SUGGESTIONS FOR FUTURE RESEARCH**

This is a highly innovative piece of research in this field and it is hoped that this study will provide impetus and direction for future pieces of research as discussed below. The study includes interviews with the variety of the senior executives of companies and tax advisory firms and their different wide-ranging experience ensures that a wide spectrum of views is included. Finding knowledgeable participants of sufficient seniority who have insights and are willing to discuss their company's approach to tax planning is inherently difficult. This study circumvents this problem through the use of networks to identify potential interviewees. The interviewees were prepared to give a comprehensive picture of their company's approach to tax planning. It also meant that a broader range of companies with different approaches to tax planning was identified.

Our initial interviews were conducted in 2016. Since then there have been significant changes in business environments in the US and the UK, such as the reduction of corporate income tax from 35% to 21% in December 2017 in the US and the Brexit referendum with the UK leaving the EU and its impacts on the location attractiveness and future business direction for UK operations of US MNEs. Whilst our follow up interviews in 2019 were able to encompass some of these changes more work is needed to understand the driving forces behind the motivation of organisations and the interaction of the individuals within them taking into consideration of changes in external environments. Future research is also suggested to explore the tax planning behaviours of MNEs headquartered in Europe, Japan and emerging economies and compare and contrast the findings with our study on US MNEs with UK subsidiaries.

Qualitative research could contribute to probe this phenomenon further. Research is also needed to provide a greater understanding of the different opportunities presented to companies, considering the industry and other factors that can drive these differences. It may be that the motivation of the MNE plays a stronger role in the position adopted than the opportunities presented. A strongly motivated company may be able to find ways of structuring their businesses enabling them to avoid tax even when it would appear to be more difficult. Research could focus on comparing the different approaches taken to strategic tax planning by companies with similar opportunities to establish the role of motivation.

By developing theory further we hope to enable researchers to consider a wider range of countries, and companies in a consistent manner. The recent changes to the US tax regime will be of interest to researchers but understanding the way in which developing countries develop and expand their tax regime is an area where scholars may be able to make a significant impact.

Whilst we focus on only two countries in this paper we intend to broaden and deepen future research in order to test our typology in different circumstances.

**CONCLUSION**

We explore the interactions between motivations and opportunities in MNE tax planning. We use a qualitative method and conduct 15 semi-structured interviews with senior executives of U.S and UK nationals of US MNEs with UK subsidiary operations and tax advisory firms. The findings are complex and nuanced. MNEs clearly adopt strategies to optimise their corporation tax expense. This is an important new finding made by this study: firms optimise rather than minimise their ETRs. This can make measuring tax avoidance and evaluating the scale of the problem difficult. It is clear from the interviews that MNEs, or those working within them, make choices about how much tax should be paid and where they should pay it.

Whilst the scope of tax avoidance practices seems to have reduced following the global financial crisis in 2008, there is uncertainty about whether this reflects a fundamental shift in attitudes within companies or simply more limited scope as a result of tighter budgets and regulations. The company’s reputation plays a key role, limiting tax minimisation and instead leading firms to adopt an “optimal” rather than “minimal” ETR.

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**Figure 1: A typology of motivation and opportunity in MNE tax planning**

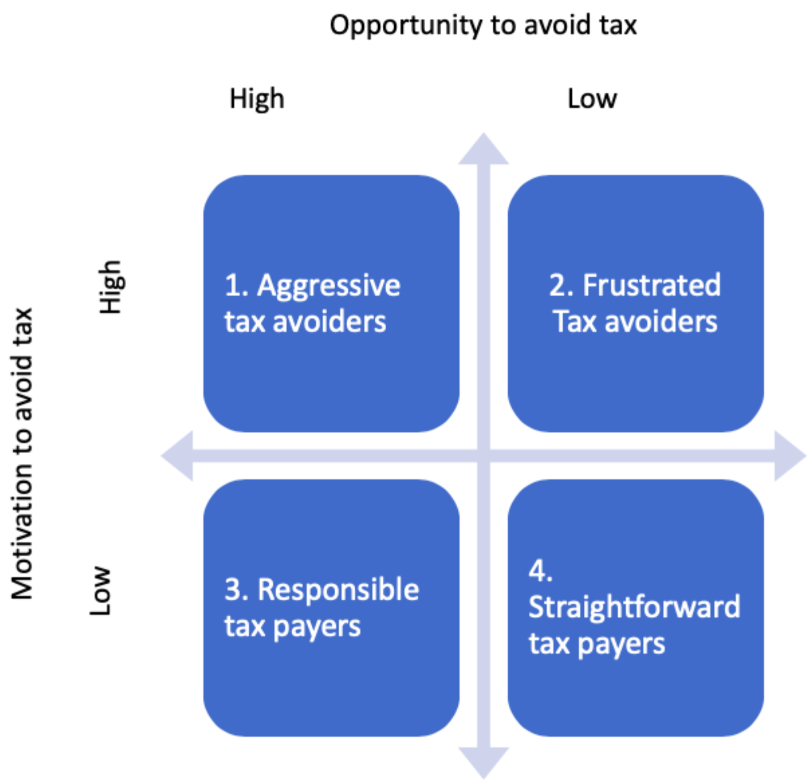

**Table 1: Summary of Key Papers on Motivation of Tax Planning**

| Reference | Research Design / Sample | Key Variables | Findings / Conclusions |
|---|---|---|---|
| **Impact of Reputation** | | | |
| Austin and Winter 2017 | Uses 'Harris Interactive's EquiTrend survey' to measure importance of brand. Include control firms with no brands. 2006 – 2011. 1,770 firms with 4,704 'brand years' in total. | IV: Measure of brand importance.<br>DVs: GAAP ETR and Cash ETR (1 and 3 year measures) | Reputation affects corporate tax planning which they argue provides partial explanation for cross sectional variation in tax avoidance |
| Chen, Huan, Li and Stanfield 2012 | Sample from Schedule 13D and 13D/A filings from the EDGAR database of the SEC. They identify 435 activist hedge funds and 2,981 activist events in the period 1994–2008. | IV: Hedge fund activism<br>DVs: 4 different measures of tax avoidance: ETR, cash ETR and two based on book tax differences. | Businesses targeted by hedge fund activists exhibit lower tax avoidance levels prior to hedge fund intervention, but experience increases in tax avoidance after the intervention. |
| Graham, Hanlon, | Survey responses from 600 corporate tax executives to | DV: 'harm to firm reputation' from survey | Find that reputational concerns are important with 69% of executives rating reputation as important. Reputation ranks second |

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| Shevlin and Shroff 2014 | investigate firms' incentives and disincentives for tax planning. | IV: Cash ETR (3 year); measure tax sheltering | in order of importance among all factors explaining why firms do not adopt a potential tax planning strategy. Also find that financial accounting incentives play a role. |
| Hanlon and Slemrod 2009 | Search Factiva database for firm names associated with tax sheltering (1990 – 2004). Sample of 97 firms | Event study methodology to test market reaction to news of tax avoidance (over 3 day period). DV: market valuation of after tax income stream<br>IV: Cash ETR 3 year period prior to event; Measure of governance of firm. | Find that, on average, a company's stock price declines when there is news about its involvement in tax shelters. This reaction is less negative for firms that are viewed to be generally less tax aggressive, as proxied by the firm's cash effective tax rate. |
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| **Impact of Management and Leadership** | | | |
| Chyz and Gaertner 2018 | Use sample of firms forcing CEOs to leave adding to previous work and compile database of 4,087 occasions using text search terms. Add financial data from Compustat. | IVs: Cash and GAAP measures of ETR<br>DV: Forced CEO turnover | Find evidence of a relationship between paying low taxes and forced CEO turnover. Forced CEO turnover is also more likely when the firm pays a high tax rate relative to its peers. |

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| Crocker and Slemrod 2005 | Paper that models the optimal incentive compensation contract for a tax manager and how the form of that contract changes in response to alternative enforcement policies imposed by the taxing authority. | | Conclude that the optimal contract may adjust to offset, perhaps only partially, the effect of any sanctions against illegal evasion. They conclude that penalties imposed on a tax manager are more effective in reducing evasion than are those imposed on shareholders. |
| Desai and Dharmapala (2006) | Analyse link between tax avoidance and management incentives. Theoretical model of the impact of incentives on choices. Use data from Compustat and Execucomp. 1993-2001. | DV: book - tax gap less accruals<br>IV: incentives, index of corporate governance quality, ratio of value of stock options / total compensation top 5 executives<br>Controls -size (logs of assets, sales, market value) | Incentive compensation appears to dive tax avoidance. Particularly true for firms with weak governance arrangements. |
| Gallemore ,Maydew and Thornock 2014 | Combines samples from prior studies of tax shelter behaviour, to create sample of 118 firms who have engaged in tax shelter activity (1995 – 2005). | IV: identification in previous studies as engaged in tax shelter<br>DV: CEO / CFO / auditor turnover; measures customer activity, being in Fortune 500. | Do not find evidence of increased chief executive officer (CEO), chief financial officer (CFO), or auditor turnover in the three years following tax shelter revelation and find no impact on customer activity (change in sales, sales growth, or advertising expense). And find now impact on the public media reputation of a firm, as measured by |

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| | | | the *Fortune* magazine list for "Most Admired Companies," |
| **Heterogeneity of tax planning** | | | |
| Dharmapala and Riedel (2013) | Uses exogenous earnings shocks at the parent firm level and investigates how these impact on profit shifting – how shocks move across the low tax and high tax MNE subs.<br>Large panel of European multinational affiliates over the period 1995–2005. 18,000 observations on 4,000 firms. | DV: log of PBT.<br>IV: construct and use measure of profit that would have expected before profit shifting.<br>Control: for variations in country characteristics. | Parents' positive earnings shocks are associated with a significantly positive increase in pre tax profits at low tax affiliates, relative to the effect on the pre tax profits of high tax affiliates. 2% of parents additional earnings are shifted to low tax subsidiaries due to the strategic use of debt across affiliates. |
| Markle and Shackelford 2009 | Financial statement data to estimate ETRs for 10,642 corporations from 85 countries from 1988 to 2007. | DV: ETR<br>IVS: Country, foreign subs (dummy), industry, size (assets, revenue, equity) | MNEs and domestic companies face similar ETRs. ETRs declined by 20% over the period. German, Japanese, Australian and Canadian decreases were large. American, British, and French declines were more modest. |
| Taylor, Richardson and Lanis 2015 | A hand-collected sample of 286 publicly listed U.S. multinational firms over the | DV: An index to measure transfer pricing aggressiveness made up of 8 | Results indicate that multinationality, tax haven utilization, and intangible assets are significantly |

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| | 2006–2012 period (2,002 firm-year observations). | components related to intra company interactions.<br>IVs: multinationality, tax haven utilisation and intangible assets. | positively associated with transfer pricing aggressiveness. |

**Table 2: Summary of Key Papers on Opportunities/ Mechanisms/ Methods Used in Tax Planning**

| Reference | Research Design / Sample | Measures Key Variables | Key Findings / Results |
|---|---|---|---|
| **Location** | | | |
| Azemar (2010) | Regresses US capital invested abroad on foreign average corporate tax rates. Uses 1992, 1994, 1996, 1998, and 2000 US Treasury CFC files compiled by the IRS. Includes the 7,500 largest foreign corporations controlled by US MNE with total assets in excess of 500 million USD. | The average tax rate for each country is calculated controlling for the impact of other determinants of US activity abroad - host country GDP, GDP per capita, and trade openness, real exchange rate, physical infrastructure, and a Law and Order index. | Investment is strongly influenced by average tax rates, particularly for low-tax rates. Firms report higher profit, higher Subpart F income, and are less likely to repatriate dividends when in low-tax jurisdictions. Low degrees of law enforcement are also associated with higher income shifting. |

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| Barrios, Huizinga, Laeven and Nicodeme (2012) | Large international firm level data set incorporating a range of European countries and companies. Consider the interaction between home and host country corporate and withholding tax systems on the location decision of MNEs. Sample analysed over multi country framework. | DV: location. IV: tax (corporate statutory rate) Controls: for market size (GDP as a ratio of the GDPs of all potential host countries); contiguity (common border); difference in labour costs (log of ratio of labour costs in home and host country), economic freedom, EU membership. | Even with deferral parent country taxes exert an effect on MNEs. Location decisions for highly profitable subsidiaries are less responsive to tax inducements than for less profitable subsidiaries. Location decisions of foreign subsidiaries with low fixed assets are more sensitive to parent and host country taxes. |
| Desai, Foley and Hines (2006) | Consider the types of firms that use tax havens and the purposes that they are used for. Sample of US MNE between 1982 and 1999 using BEA survey data. | DVs: haven dummy, share of affiliates in havens, share affiliate sales in havens, share haven affiliates in Big 7 havens, share affiliate sales in Big 7 havens, ratio foreign taxes to sales, affiliate sales growth in non tax havens, affiliate net PPE growth in non tax havens.<br>IVs: log of non haven sales, log of parent sales, av non haven tax rate, ind. Av non tax haven tax rate, ind | Larger, more international, more R&D intensive firms and those with more intra company transactions are more likely to have tax haven companies. Find that use of large tax haven countries are to reallocate taxable income. Smaller tax havens are used more to defer repatriation |

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| | | share of sales to related parties abroad, parent ind R&D ratio, own affiliate in haven, parent owns affiliates only in dot tax havens, country tax rate, leverage, leverage interacted with country tax rate, begin of period sales in havens, beg period net PPE in havens, GDP growth rate. | |
| Devereux and Griffith (2003) | Develops theory and new measure of average ETR to consider the choices made by MNE in particular location. Estimates EATR for series of countries 1979 – 1999. | Forward looking average ETR measured using weighted average of an effective marginal tax rate and an adjusted statutory tax rate with weights dependent on profitability. | Concludes that more profitable investments are more responsive than less profitable investments. |
| De Mooij and Ederveen (2006) | Based on met analysis to understand variation in elasticity FDI to corporate tax rates. Transform findings from each study into tax rate elasticities – how FDI changes in response to tax rate change. | DV: FDI (range of measures). IV: Tax rate (range of measures). Control for study characteristics – type of capital data used; type of tax data used; whether home country adopts credit or exemption system; distance; time. | Heterogeneity of approaches in research means can't make single estimate. Median value of elasticities of 2.9. Type of capital data used is important – amount of capital invested is more responsive to taxes than the location itself. |

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| Hines and Rice 1994 | Considers ability of MNEs to shift real activity and profits between tax jurisdictions. Identify 41 countries as tax havens, the split between 'dot' havens and larger. | DV – pre tax non financial income.<br>IV – tax rate<br>Control for capital and labour inputs.<br>Control for productivity (log GDP per capita) | Tax haven subsidiaries account for more than 20% of US FDI and a third of profits. Revenue maximizing tax rate for tax haven is 5-8%. Find tax rate has significant negative impact on income. 1 % higher tax rate results in 3% lower reported profits. |
| **Transfer pricing** | | | |
| Rugman (1985) | Theoretical paper applying internalization theory to the Canadian petroleum industry and criticizes a paper on TP. | | |
| Eden, Valdez and Li (2005). | Event study methodology using the stock market prices of American Depository Receipts of all Japanese MNEs with US subsidiaries over the 1990s to assess the impact of the US TP penalty on the stock market valuation of Japanese MNEs with US subsidiaries in the 1990s. | | Find that the penalty caused a drop in their cumulative market value of \$56.1 billion, representing 12.6% of their 1997 market value |

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| Clausing (2003) | Monthly data on US international trade prices over 1997, 1998, and 1999 to investigate the impact of tax on intrafirm trade prices. 425,000 observations of monthly prices. 33% of these observations are for exports. 38% observations are intrafirm trade. 54 countries. | DV: prices of products – intrafirm and non intrafirm<br>IVs: ETR and statutory tax rates<br>Control: exchange rates, industry, whether price originally in $. | Substantial evidence of tax-motivated TP in US intrafirm trade prices. Strong and statistically significant relationship between countries' tax rates and the prices of intrafirm transactions. As country tax rates are lower US intrafirm export prices are lower, and US intrafirm import prices are higher. |

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| Zucman (2014) | Uses national balance sheet data to estimate amount held in tax havens. Overall more financial securities are recorded as liabilities than assets. Estimates overall tax loss to governments. Computes ETR at US national level. | BOP statistics to show where income is held (not generated).<br>BEA data – estimate taxes paid by US firms on the profits recorded in tax havens.<br>US national ETR – divides all corporate taxes paid by US firms by US profits. | From 1998 – 2013 US ETR fell from 30% to 20% - 2/3 this change can be attributed to tax avoidance.<br>Concludes that 2008-2013 the amount of money in tax havens increased by 25%. Hidden wealth accounts for $7.6trillion. |
| **Intangible assets, royalties and overheads** | | | |
| Grubert (2003) | How tax planning and use of IP and debt affect ETR. To which subsidiary profits should be allocated when made across countries. | Calculates overall ETR on US manufacturing abroad and decomposes. Then uses data from company reports to Treasury to calculate ETR at subsidiary level to see which pay above / below average in different locations. | Taxation of royalties, use of tax havens, and allocation of interest expenses impact ETR. Host countries favour mobile investment and those offering employment to locals. Exporters are treated favourably but importers are penalized. Subsidiaries of R&D intensive companies pay higher ETR - host country governments extract rents. |
| Gravelle (2009) | Article reporting on use of tax havens and their definition. | Literature review summarising previously published research and | Corporate profit shifting may cost the US government up to $60 billion in |

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| | Estimates amount of tax revenue lost to US government from use of havens. | concluding on potential policy options. | revenue and remedies are likely to involve tax law changes. |
| Dyreng, Hanlon and Maydew (2008) | 2,077 firms (1995–2004). Only those with profits. Extent to which some firms are able to avoid taxes over periods as long as 10 years, and how predictive one-year tax rates are for long-run tax avoidance | Develop and describe new measure of LT (10yr) corporate tax avoidance (Cash ETR). | Find considerable cross-sectional variation in tax avoidance. Annual cash ETR are not good predictors of LT cash ETR. Low annual cash ETR are more persistent than are high annual cash ETR. Firms successful at keeping their cash ETR low over long periods are well spread across industries but with some clustering. |
| Shackelford, Slemrod & Sallee, 2011 | Theoretical paper presenting a formal model of the idea that some investment decisions may be more attractive because they provide managers with discretion over the timing of taxable income and/or book income | | |

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| Grubert and Mutti (2007) | Uses US Treasury tax return data from US CFCs. Compares earnings from royalties etc in 1996 and 2002 after introduction of check the box. Also uses BEA data on affiliate operations and royalty payments. | Some regression analysis but largely discussion of trends in data on royalties, CFC income and IP. | Hybrid firms have enabled greater migration of IP assets out of the US. Firms have incentive to leave returns to R&D abroad. Parent R&D was a more important determinant of royalty payments to US parents than affiliate earnings and profits in 1996, but played a larger role in earnings and profits than royalties by 2002. |
| Dischinger and Riedel (2011) | Use panel data from AMADEUS on European MNEs and control for heterogeneity between affiliates. Focus on industrial EU parent and subsidiaries-25 1995–2005.<br>At least 3 subsidiaries to ensure sufficient size so that can observe strategic allocation intangibles. Exclude MNE with losses. | DV: intangible assets<br>IVs: statutory tax rates (home and host), unweighted average corporate tax rate relative to other subsidiaries<br>Control: GDP per capita, population, R&D expenditures as % GDP, corruption index, unemployment rate | The lower a subsidiary's corporate tax rate relative to other affiliates of the group the higher is its level of intangible asset investment. Effect is statistically and economically significant, even after controlling for size etc. Mean value of intangible assets for both parent and subsidiaries is increasing over time. |

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| ***Internal debt and capital structure*** | | | |
| Gordon & Lee 2001 | Time series data; US corporate income tax returns (1954-1995) and balance sheet data on all corporations, to estimate the effects of changes in corporate tax rates on the debt policies of firms of different sizes. | DV: debt ratio (total, LT and ST debt)<br>IVs: statutory and ETR<br>Controls: real assets per return, net assets, land/assets, cash/assets, accounts receivable / assets, intangible assets / assets. | Taxes have had a strong and statistically significant effect on debt levels. If the corporate tax rate is cut by 10%, holding personal tax rates fixed, this will reduce the fraction of assets financed with debt by around 3.5%. |
| Egger, Eggert, Keuschnigg and Winner (2010), | How financial decisions affected by tax. Considers debt to asset ratio for domestic and foreign owned plants and the extent to which difference is systematically related to corporate taxation. Data from 32,000 European MNE. | DV: debt ratio<br>IV: statutory tax rate, loss carryforwards to correct statutory rate.<br>Controls: Foreign MNE ownership, firm age, plants per region and industry, employees, regional worker compensation, cost intermediate goods, total assets. | Find that foreign-owned firms have higher debt ratio than domestically owned counterparts in the host country. Difference increases with the host country's statutory corporate tax rate. |
| ***Losses carried forward*** | | | |
| Markle and Shackelford 2009 | Financial statement data to estimate ETRs for 10,642 corporations from 85 countries | DV: ETR<br>IVS: Country, foreign subs (dummy), industry, size (assets, revenue, equity) | MNEs and domestic companies face similar ETRs. ETRs declined by 20% over the period. German, Japanese, |

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|---|---|---|---|
| | from 1988 to 2007. | | Australian and Canadian decreases were large. American, British, and French declines were more modest. |
| Dharmapala and Riedel (2013) | Uses exogenous earnings shocks at the parent firm level and investigates how these impact on profit shifting – how shocks move across the low tax and high tax MNE subs.<br>Large panel of European multinational affiliates over the period 1995–2005. 18,000 observations on 4,000 firms. | DV: log of PBT.<br>IV: construct and use measure of profit that would have expected before profit shifting.<br>Control: for variations in country characteristics. | Parents' positive earnings shocks are associated with a significantly positive increase in pre tax profits at low tax affiliates, relative to the effect on the pre tax profits of high tax affiliates. 2% of parents additional earnings are shifted to low tax subsidiaries due to the strategic use of debt across affiliates. |
| Hanlon and Heitzman (2010) | Literature review covering: (1) Financial accounting for income tax expense, (2) corporate tax avoidance, (3) corporate decision-making (4) taxes and asset pricing. | | |

**Table 3: Background information of senior tax executives for interviews and organizations**

| *Interview* | *Individual (s)* | *Organisation* |
|---|---|---|
| **First round of interviews in 2016 and second round of follow-up interviews in 2019** | | |
| Interview 1 | UK national. Qualified with smaller audit company before moving to Big 4 firm as tax accountant. With company for 7 years. | Consumer staples company |
| Interview 2 | Two US nationals. One tax specialist in UK on secondment for a year, been with company for 30 years. One Chief Operating Officer, been with company for 8 years. | Industrials company |
| Interview 3 | UK national. Qualified with Big 4 firm. Been with company for 10 plus years. | Telecommunications company |
| Interview 4 | US national. Qualified with Big 4 firm. Works out of US. Been with company 5 plus years | Consumer staples company |
| Interview 5 | UK national. Qualified with Big 4 firm. Worked for another company for 10 years which was taken over by current company 8 years ago. | Financial Industry |
| Interview 6 and 12 | Qualified 35 years ago. Varied career in tax throughout specific industry including time with Big 4 firm. | Financial Industry |
| Interview 7 and 14 | Qualified with Big 4 firm and worked there 18 years. Recently (2 plus years ago) moved into industry | Financial Industry |
| Interview 8 | UK national. Tax Partner with Big 4 firm. Worked there 25 plus years. | Big 4 audit firm |
| Interview 9 and 13 | US national. Worked as Tax Partner in Big 4 firm. Now works at boutique tax advisory firm. Worked in Tax 30 plus years | Boutique tax advisory firm |

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| Interview 10 and 15 | US national. Tax Partner at Big 4 firm. Has worked for 2 big 4 firms over 30 plus year career. | Big 4 audit firm |
| Interview 11 | UK national. 30 year career in industry including work as transfer pricing specialist covering significant legal cases. Now an independent transfer pricing consultant | Independent transfer pricing consultant |

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