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Jan. 10, 2017

How much tax should U.S. corporations pay? Even as a national legislative consensus seems to be growing that the current federal statutory rate of 35% is too high, a large swath of public opinion, particularly on the political left, contends that companies too often find ways to pay less than their fair share.

Indeed, suspicions about company successes in lowering their taxes are not confined

conceding that in some cases they probably are, as a general matter that seems not to be the case, new research suggests. The study in the current issue of ***The Accounting Review,*** published by the **American Accounting Association**, puts its conclusion succinctly: "Our results do not support the contention that tax avoidance activities that lower a business's tax rate are associated with a greater degree of risk... Our results are not consistent with lower tax rates being associated with more risk."

To reach this conclusion, the paper's authors, David A. Guenther and Steven R. Matsunaga of the University of Oregon and Brian M. Williams of Indiana University, conducted three riskiness tests – 1) whether low effective tax rates (ETRs) that a company achieves prove merely temporary, being less persistent then higher rates; 2) whether low ETRs are more predictive than higher rates of future tax volatility; and 3) whether low tax rates are associated with greater uncertainty about the business's overall future cash flow, as reflected in greater future stock-price volatility.

In all three tests, low taxes proved not to be associated with corporate risk. Comments Prof. Guenther: "The current statutory rate may not be to companies' liking, but we don't find that it's driving managers into risky behavior. Our findings suggest a company's low taxes to be more reflective of skilled management than risky management."

On whether low tax rates are persistent, the professors found that not only are companies with low ETRs no more likely than others to pay higher rates in succeeding years, they are *significantly less likely to do so*. Thus, when companies were divided into five groups from lowest to highest ETRs, companies in the quintile that paid the lowest rates in a given five-year period had a 40% likelihood in remaining in that quintile in the succeeding five-year period, a significantly higher persistence than for any other quintile. In the words of the study, "this is contrary to the prediction…that low ETRs have low persistence because [low rates entail] taking

What does appear to be a harbinger of future financial troubles is not a low tax rate *per se* but ups and downs in ETRs – in other words, tax-rate volatility – which the professors found to be predictive of future stock-price volatility. A potential explanation for this, they write, "is that past volatility leads to greater uncertainty regarding the business's future tax rate and overall uncertainty regarding the entity's future cash flows."

The study's findings are based on analyses of the finances and taxes of a large sample of businesses over a 25-year period, analyses that for some measures involve as much as 39,000 company-years of data. ETRs were calculated both for taxes that companies acknowledged on financial statements and tax payments actually made over three-year and five-year periods.

What accounts for findings that run counter to common assumptions in business and finance? One possible explanation, the authors observe, is absence of enforcement. In the words of the study, "aggressive tax positions will only result in high future payments if the IRS identifies the issue, chooses to challenge the position, and is successful in their challenge… In actual practice the positions are not reversed in the future, either because they are not identified and challenged or because the company's legal representation is able to reach a favorable outcome."

In the end, though, the professors lean toward a more accepting view. "Overall," they write in conclusion, "our findings are most consistent with the idea that low ETRs reflect the extent to which a firm's operations allow the entity to take advantage of benign tax-favored transactions as opposed to differences in managers' willingness to reduce the firm's tax payments through risky tax positions."

The new study, entitled "Is Tax Avoidance Related to Firm Risk?" is in the January/February issue of ***The Accounting Review***, published six times yearly by the **American Accounting Association**, a worldwide organization devoted to

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