# *Session Two:*

## *Administering the Corporation Income Tax in the 21st Century*

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2008 IRS Research Conference

# Administering the Corporation Income Tax in the 21st Century

*Summary of Repatriated Dividend Study*

Redmiles

*FIN 48 and Tax Compliance*

Mills, Robinson, and Sansing

*Electronic Tax Return Filing, Enterprise Data Structures and Tax Compliance Risk Assessment*

Boynton, Trautman, and Lisowsky

# Common themes

- The first paper provides an example of how tax return information provides data to evaluate tax policy decisions.
- The second, about how changes in the regulatory environment might influence reporting decisions that are used by the IRS.
- The third, how technology might be used to better assess compliance though greater use of data.
- *All three highlight the importance of the interrelationships between tax and financial reporting.*

# Redmiles

- What do tax returns show the effects of AJCA 2004 repatriation provisions to be?
- Note that there has been substantial speculation and estimates from publicly-available data
    - Bear Stearns (2005) $420 billion for the S&P 500
    - Albring et al. (2005) find 678 corporations total, and $426 billion

# Redmiles

## Eli Lilly, FY 2004 AR

we believe we have the information necessary to make an informed decision on the impact of the AJCA on our repatriation plans. Based on that decision, we plan to **repatriate $8.00 billion** in incentive dividends, as defined in the AJCA, during 2005 and accordingly have recorded a related tax liability of $465.0 million as of December 31, 2004. Potential uses of proceeds from the incentive dividends include research and development activities, capital asset expenditures, and other permitted activities.

# Redmiles

**Pfizer FY 2005 AR**

In 2005, we recorded an income tax charge of $1.7 billion, included in Provision for taxes on income, in connection with our decision to **repatriate approximately $37 billion** of foreign earnings in accordance with the American Jobs Creation Act of 2004 (the Jobs Act). The Jobs Act created a temporary incentive for U.S. corporations to repatriate accumulated income earned abroad by providing an 85% dividend-received deduction for certain dividends from controlled foreign corporations in 2005. In addition, during 2005, we recorded a tax benefit of $586 million, primarily related to the resolution of certain tax positions.

# Redmiles

**Merck, FY 2005 AR**

In connection with the AJCA, the Company **repatriated $15.9 billion** during 2005. As a result of this repatriation, the Company recorded an income tax charge of $766.5 million in Taxes on Income in 2005 related to this repatriation. This charge was partially offset by a $100 million benefit associated with a decision to implement certain tax planning strategies. The

Company has not changed its intention to indefinitely reinvest accumulated earnings earned subsequent to December 31, 2002. At December 31, 2005, foreign earnings of $8.3 billion have been retained indefinitely by subsidiary companies for reinvestment. No provision will be made for income taxes that would be payable upon the distribution of such earnings and it is not practicable to determine the amount of the related unrecognized deferred income tax liability.

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# Redmiles

- **$362 billion v $426 billion estimated from 10-Ks**
- XOM FY 2005
  - The Corporation had **$41 billion** of indefinitely reinvested, undistributed earnings from subsidiary companies outside the U.S. Unrecognized deferred taxes on remittance of these funds are not expected to be material
- Chevron FY 2004
  - In early 2005, the company was in the process of reviewing the guidance that the IRS issued on January 13, 2005, regarding this provision and also considering other relevant information. The company does not anticipate a major change in its plans for repatriating earnings from international operations under the provisions of the Act.
  - Undistributed earnings of international consolidated subsidiaries and affiliates for which no deferred income tax provision has been made for possible future remittances totaled approximately **$10,000 (million)** at December 31, 2004.

# Redmiles

- Other observations
  - Where it came from
    - When in doubt,  guess "Netherlands" or "Pharma"
  - Investment pattern
    - Fairly rapid – 70% within two years
  - Opportunity for a natural extension to combine this with the public data for a fuller understanding of the effects of the provision, and the usefulness of financial data

# Mills, Robinson, and Sansing

Conclusions

- Taxpayers are not necessarily harmed by FIN 48
- Liability disclosed under FIN 48 may be overstated or understated relative to the expected outcome
- FIN 48 does not necessarily induce more high income reporting

# Mills, Robinson, and Sansing

- Asymmetric costs
  - IRS cost of audit, *c,* versus firms' benefit, *x*
    - are firms' audit costs in *x?*
    - While $\alpha$ is negatively related to *c,* is *c* decreasing?
  - But does the IRS have "low or no cost" opportunities to audit?
    - Audit probability may be unchanged or higher for most firms
- Only one dial for the firm to dial
  - Assumes assessment of risk is the same even after result of assessment is becomes a factor in disclosure.

# Mills, Robinson, and Sansing

Empirical tests

- Does the IRS more frequently audit returns with high disclosed liabilities relative to claimed tax benefits?
  - Problematic, if firms are already audited
  - IRS has unused tools
- Does FIN 48 reduce the amount of tax planning done in large public companies.
  - Further, does it change the nature of planning and reporting?
- What about XML?
  - Is $c$ declining? Is $\alpha$ increasing?

# Boynton, Trautman, and Lisowsky

- Key issues:
- Many business enterprises are far more complex than can be inferred.
- Have a enhanced capability to consolidate large amounts of data at a relatively low cost.

# Boynton, Trautman, and Lisowsky

- Next steps
  - Incorporate Financial Statement and Related Entity Data
  - Identification of Related Entities (e.g., Schedule K-1) (and Other Sources)
  - Resolve Complex Entity Relationships

- Questions
  - 1099 and W-2s?
  - Facilitate the incorporation of other regulatory reports:

**"SEC to require mandatory XBRL filing in 2009"**

# Boynton, Trautman, and Lisowsky

Uses:

- Tax Shelter Detection
- Book-Tax Analysis
- Simulation Modeling

- These are only the beginning
  - Potential for far more extensive research on business behavior.
  - Should decrease costs of both compliance and monitoring.

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