CORPORATE TAX AGGRESSIVENESS —
RECENT HISTORY AND POLICY OPTIONS

J. Richard (Dick) Harvey, Jr.

This paper examines corporate tax aggressiveness from the 1990s to 2014. The paper also discusses various public indicia of corporate tax aggressiveness and analyzes selected data from 21 public companies. Finally, the paper discusses several policy options for further reducing corporate tax aggressiveness, including: (1) improvements to the IRS whistleblower program, (2) increased transparency, and (3) changes to the penalty structure surrounding aggressive tax positions.

Keywords: corporate tax aggressiveness, transparency, Schedule UTP, penalties, IRS whistleblower program, income shifting

JEL Codes: H25 and H26

I. INTRODUCTION

Aggressive corporate tax planning has existed throughout history and will likely continue for as long as corporations are subject to tax. However, the degree of corporate tax aggressiveness can ebb and flow, depending upon whether corporations perceive that the benefits of such practices exceed their costs.

This paper is divided into seven sections. Following this introduction, Section II defines corporate tax aggressiveness with particular attention to how corporate managers view aggressiveness. Sections III and IV briefly describes the recent history surrounding corporate tax aggressiveness, including: (1) the very aggressive state of corporate tax planning during the 1990s and early 2000s; (2) events that have likely curtailed corporate tax planning since the early 2000s; and (3) the current state of corporate tax aggressiveness. Section V discusses potential indicators of corporate tax aggressiveness based on publicly available data, while Section VI analyzes the aggregate and individual data from 21 public corporations. Section VII provides a set of policy options that could be considered to address tax aggressiveness, all of which are aimed at altering a corporation’s cost/benefit analysis surrounding aggressive tax positions. Finally, Section VIII summarizes the key topics discussed in this paper.

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II. DEFINITION OF CORPORATE TAX AGGRESSIVENESS

Although there can be many definitions of corporate tax aggressiveness, based on over 35 years as a tax professional, the “real world” definition used by corporations is usually based upon the degree of tax risk a corporation believes it is taking. The two main components of tax risk are (1) technical tax risk, and (2) reputational risk.

Historically, corporations were primarily concerned with technical tax challenges to a tax position that could result in the payment of tax, interest, and penalties upon audit. However, high profile government hearings and whistleblower claims, coupled with a constant barrage of negative articles in the press, have caused many corporations to become substantially more concerned about reputational risk. In fact, some corporations are likely more concerned about reputational risk than they are technical tax risk.

From a corporation’s perspective, the most aggressive tax positions are those that have both high technical tax risk and high reputational risk. However, some tax positions that may have only modest technical tax risk may also be considered very aggressive because of the reputational risk associated with the tax position. A prime example of this type of aggressive position may be the shifting of income to low-tax foreign jurisdictions or participating in a corporate inversion. Both of these actions may be relatively sound positions from a technical tax perspective, but both could have significant reputational risk.

III. RECENT HISTORY

A. 1990s and Early 2000s

During this period, corporate tax departments were often viewed as a profit center managing a portfolio of tax issues with significant emphasis on reducing the effective tax rate (ETR) disclosed in financial statements. In addition, “retail” corporate tax shelters were relatively common. These shelters were aggressively marketed by investment banks, accountants, and lawyers under many marketing labels, including Tempest, Othello, STARS, and MIDCO transactions. Individual tax shelters like BLIPS, OPIS, BOSS, Son of BOSS, and FLIP were also actively being marketed during this period.

In summary, some might view the 1990s and early 2000s as the glory days of corporate tax shelters, while others may view it as the “wild west.” Regardless of one’s views, many corporations took very aggressive tax positions with the belief that tax authorities would not identify all positions, and even when positions were identified and challenged, corporations would likely settle the issues on favorable terms based

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1 This includes experience as a senior tax partner in a Big 4 accounting firm and as a senior government official. Blouin (2014) provides an analysis of definitions advanced by academics.
2 An inversion is when a U.S. multinational corporation changes the tax residence of its parent from the United States to a more favorable foreign tax jurisdiction.
3 The hearings held by the U.S. Senate (2003) provide more information on these issues.
on at least a modicum of technical soundness. Most corporations successfully executed this strategy.

B. Post-2000

During this period, several factors impacted the ability of corporations to successfully execute aggressive tax planning, especially retail corporate tax shelters. These factors are discussed below.

1. Sarbanes-Oxley

Enacted in 2002, this far-reaching legislation effectively forced senior corporate officials to focus more attention on aggressive tax planning. First, Sarbanes-Oxley requires that CEOs sign the corporate tax return. And second, it required the board of directors (BOD) to approve all tax services provided by the company’s external auditor.

Prior to Sarbanes-Oxley, a business’s external auditor could propose a corporate tax strategy, issue a tax opinion, and then approve the financial statement tax reserve, if any, for the strategy. Some argued this was a conflict of interest. Although Sarbanes-Oxley did not prohibit external auditors from proposing and implementing tax strategies, the practical effect was that most BODs substantially restricted the practice, especially for tax strategies that could have a material effect on the business’s financial statements. In some cases, BODs prohibited their external auditors from providing any tax services.

Regardless of a BOD’s decision surrounding the provision of tax services by their external auditor or some other tax advisor, there were two major practical effects of Sarbanes-Oxley on corporate tax planning. First, BODs became more involved in tax matters. Prior to Sarbanes-Oxley, the corporate tax department was often regarded as a “black box” producing low ETRs that rarely interacted with the BOD. After passage of Sarbanes-Oxley, BODs were required to become much more involved in tax issues as part of their greater financial statement oversight responsibilities, and had to specifically approve any tax strategies proposed by their external auditors.

Second, it became less likely that external auditors would audit their own tax strategies. Because of the appearance of a conflict of interest, many BODs prohibited external auditors from proposing material tax strategies. Thus, most external auditors started auditing other tax advisors’ strategies. This likely resulted in a more objective evaluation of the quality of various corporate tax strategies with the result that corporations became somewhat less aggressive in their tax planning.

2. Substantial Increase in Corporate Tax Transparency

During the post-2000 era, there was a significant increase in corporate tax transparency. As a result, large corporations found it increasingly difficult to play the audit
lottery (i.e., hope the IRS would not identify an aggressive tax position). Increases in transparency are discussed below.

Financial Accounting Standards Board Interpretation Number 48 (FIN 48). The adoption of FIN 48 in 2006 altered a corporation’s cost/benefit analysis when considering whether to take an aggressive tax position. First, FIN 48 made it more difficult for a business to avoid recording a tax reserve, and second, the tax footnote disclosure surrounding unrecognized tax benefits (UTBs) increased significantly. For example, corporations do not like appearing at the top of the Ferraro 500 list of corporations with the largest UTBs.

Schedule UTP (Uncertain Tax Position). The adoption of FIN 48 ultimately made it possible for the IRS to adopt Schedule UTP in 2010. In general, if a corporation records a reserve for a tax issue in its audited financial statements, Schedule UTP requires the corporation to disclose the tax issue to the IRS. The IRS’s adoption of Schedule UTP was described by one former IRS Commissioner as “the biggest change in tax administration in the last 50 years” Fahey (2010, p. 371) and was met with almost uniform opposition by the corporate tax community. Nevertheless, corporations are now required to make disclosures to the IRS of many issues that would never have been previously disclosed.

Reportable and Listed Transactions. In 2002 and 2003, the IRS issued temporary and final regulations surrounding reportable transactions, including listed transactions. As a result, corporations are required to disclose reportable transactions on Form 8886 and material advisors are required to file Form 8918. Reportable and listed transactions were the IRS’s effort at the time to identify both known and potential individual and corporate tax shelters. Although the regulations were not very good at identifying future transactions, the IRS was successful at obtaining substantial information on prior listed transactions, especially from tax shelter promoters. The IRS successfully litigated many of these listed transactions (e.g., LILOs/SILOs and Son of BOSS).

Narrowing of the IRS’s Policy of Restraint. In 2002, closely related to the IRS’s efforts surrounding reportable transactions, the IRS issued Announcement 2002-63, which expanded the IRS’s intention to obtain a corporation’s tax accrual workpapers (TAWs). Specifically, the IRS announced it would pursue TAWs if a corporation participated in a listed transaction. The IRS ultimately obtained TAWs for over one hundred taxpayers, including Textron. The end result of Announcement 2002-63 was that corporations

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4 For public companies, FIN 48 was effective for years beginning after December 15, 2006. FIN 48 was not effective for private companies until years beginning after December 15, 2007.

5 Unrecognized tax benefit is another name for a tax reserve; these terms will be used interchangeably.


7 Harvey (2011) provides a comprehensive discussion on Schedule UTP.

8 TAWs include a corporation’s list of tax reserves by issue, and can also include tax opinions and analysis surrounding various tax positions. Suffice it to say that corporations do not want the IRS obtaining their TAWs. However, in a 1984 U.S. Supreme Court case, United States v. Arthur Young & Co., 465 U.S. 805, the IRS won the right to obtain TAWs. However, the IRS soon thereafter announced a policy of restraint, stating it would exercise this right only in unusual circumstances.

9 In a closely followed case, Textron challenged the IRS’s ability to obtain TAWs. After a prolonged litigation, the IRS ultimately prevailed; see Textron, 577 F. 3d 21 (1st Cir. 2009).
were more reluctant to participate in an aggressive tax transaction, as participation in a transaction that became listed could cause the corporation to be required to disclose its very sensitive TAWs.

**Disclosure of Tax Penalties.** In 2004, the American Jobs Creation Act added Sections 6707A and 6662A to the Internal Revenue Code which require that tax penalties related to reportable transactions and listed transactions be specifically disclosed in a public corporation’s annual report (i.e., on Form 10-K). Corporate tax departments generally want to avoid such disclosures.

**Schedule M-3.** In 2004, the IRS announced Schedule M-3. The primary purposes of Schedule M-3 were to require corporations (1) to reconcile differences between the pre-tax income reported on their audited financial statements and the taxable income disclosed on Form 1120; and (2) to distinguish between permanent and timing differences in the reconciliation. The end result of Schedule M-3 is the IRS now has more information about differences between financial statement accounting and tax accounting.

**The IRS Whistleblower Program.** In 2006, IRC 7623(b) was enacted to encourage whistleblowers to report information to the IRS by providing for a reward of 15 to 30 percent of the additional tax proceeds collected by the IRS. Based upon discussions with corporate tax directors during my career, there are few things that cause more anxiety than the possibility that one of their trusted employees may become a whistleblower. In addition to effectively providing the IRS a detailed roadmap to areas of corporate tax aggressiveness, whistleblowers who go public with their accusations (e.g., like employees of Caterpillar and Levi Strauss discussed below), can quickly cause a nightmare for a corporation and its tax department. Thus, the fear of whistleblowers has definitely impacted the willingness of corporations to enter into aggressive tax positions.

In summary, increased transparency in both financial statements and tax returns has altered the cost-benefit analysis surrounding aggressive corporate tax positions.

### 3. Economic Substance/Business Purpose

Prior to the late 1990s, many tax advisors were of the view that the economic substance/business purpose doctrine, which requires that any tax transaction have sufficient economic substance and business purpose and not be designed purely for tax avoidance, was not to be feared. This view started to change with the ACM Partnership case, when the IRS successfully argued that one step in a complex transaction did not have business purposes and thus the transaction did not deliver the expected tax benefits to the participants.\(^{10}\) The IRS continued to win similar cases during the 2000s, including all of the popular corporate tax shelter cases referred to as SILOs or LILOs.

Finally, IRC 6662(b)(6) and 7701(o), enacted in 2010, codified the economic substance doctrine, including a strict liability penalty and a requirement to disclose transactions that may lack economic substance to avoid an even greater penalty. The end result is that corporations now must ensure that any aggressive tax transaction has sufficient economic substance and business purpose.

\(^{10}\) *ACM Partnership v. Commissioner*, 157 F.3d 231 (3d Cir. 1998).
4. Significant Increase in Reputation Risk

Prior to the 2000s, corporations taking aggressive tax positions and the lawyers, accountants, and investment bankers selling corporate tax shelters rarely incurred any reputation risk from their activity. Positions were challenged by various tax authorities, but this was always done very privately. This started to change in the early 2000s. The following events are especially noteworthy.

Enron Tax Planning Exposed. After Enron went bankrupt, the Joint Committee of Taxation produced a report that provided a detailed account of Enron’s elaborate corporate tax planning (Joint Committee on Taxation, 2003).

U.S. Senate Hearings on Tax Advisors. The Permanent Subcommittee on Investigations (PSI) of the U.S. Senate, held hearings in November of 2003 where several of the large accounting and law firms where publicly humiliated for their participation in tax shelters (U.S. Senate, 2003).

KPMG Deferred Prosecution Agreement and Fine. In 2005, KPMG entered into a deferred prosecution agreement with the Justice Department and agreed to pay a $465 million fine. In addition, various criminal proceedings were initiated against some of its partners.11

Ernst & Young Admission of Wrongful Conduct and Fine. In 2013, Ernst & Young agreed to pay a $123 million fine and admitted to wrongful conduct by some of its partners and employees in connection with the promotion of abusive tax shelters. The individuals involved were already going through separate criminal proceedings.12

More PSI Hearings on Income Shifting. From 2012 to 2014, the PSI held three very highly publicized hearings surrounding the shifting of income to low-tax foreign jurisdictions, including creative repatriation strategies. The firms involved were Microsoft and Hewlett Packard, Apple, and Caterpillar (U.S. Senate, 2012, 2013, and 2014).

UK Parliamentary Hearings. In November 2012, the UK Public Accounts Committee of Parliament held hearings surrounding the international tax planning activities of Starbucks, Google, and Amazon. As a result of the public backlash from those hearings, Starbucks agreed to make a 20 million pound payment to the UK government, and announced in early 2014 that they will move their headquarters for most of their international operations from the Netherlands to the UK which should further increase their UK tax burden in the future. In addition, in February 2013, the UK Public Accounts Committee held its second round of hearings on corporate tax avoidance, this time focusing on the Big 4 accounting firms.

Various Whistleblower Activities. An employee of Caterpillar became engaged in litigation surrounding Caterpillar’s corporate tax planning, which resulted in many

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12 For more on this issue, see United States Attorney’s Office Southern District of New York (2013). In addition, both Grant Thornton and BDO have had major issues surrounding their tax planning, as discussed by Rapoport (2013) and Joint Committee on Taxation (2003).
corporate documents being released into the public domain, and hearings being held by the PSI to investigate these strategies. In addition, two employees of Levi Strauss engaged in another highly publicized tax whistleblower claim.

In summary, after the turn of the millennium, the reputational risk associated with corporate tax planning started to increase exponentially for both corporations and tax shelter promoters. Corporate tax departments and their BODs had become highly sensitized to the reputation risks associated with aggressive corporate tax planning.

IV. THE CURRENT STATE OF CORPORATE TAX AGGRESSIVENESS

Based on personal experience and discussions with corporate tax directors, corporations are, with one exception, generally less aggressive today than they were in the 1990s and early 2000s. This is not a startling conclusion, given the accumulated impact of the tax planning hurdles described in Section III.B. For example, most corporate tax departments now assume: (1) an uncertain tax position (UTP) will be audited; (2) their external auditor will take a hard look at the UTP for financial statement purposes; (3) there could be significant reputation risk associated with a UTP; and (4) a tax-driven transaction needs to have sufficient economic substance and business purpose.

The one notable exception to this trend is that many multinational corporations (MNCs) have become more aggressive at shifting income into low-tax foreign jurisdictions. This activity has been driven by the IRS’s successful economic substance attacks on structured transactions. As a result, shifting income is the only feasible tax strategy left that can materially impact many corporations’ effective tax rate. In addition, the 2004 enactment of a tax holiday on repatriated foreign earnings suggested to U.S. MNCs that another tax holiday may be forthcoming. In order to maximize the potential future benefit of such a tax holiday, U.S. MNCs are shifting as much income overseas as they believe reasonably possible.

Recent Congressional hearings in the United States and Parliamentary hearings in the UK have further confirmed there is a significant amount of income shifting taking place and have led to the Organisation for Economic Co-operation and Development (OECD) to initiate its highly publicized Base Erosion and Profit Shifting (BEPS) project.

V. POTENTIAL INDICATORS OF CORPORATE TAX AGGRESSIVENESS

Based on my more than 35 years of corporate tax experience, I provide in this section my list of the best publicly available indicators of corporate tax aggressiveness. These indicators may be useful to others that are studying corporate tax aggressiveness and have far better statistical abilities than this author.

13 For example, in 2009 the U.S. Senate seriously considered another tax holiday, but it was ultimately not enacted.

14 Information on the BEPS project is available at http://www.oecd.org/ctp/beps.htm.
A. Low Total Effective Tax Rate

Given that FIN 48 has improved tax reserve consistency between corporations, a low total effective tax rate (ETR) over a number of years can be a very good indicator of corporate tax aggressiveness. However, there is one major caveat, as U.S. Generally Accepted Accounting Principles (GAAP) require that U.S. income taxes be estimated on foreign earnings whether or not these earnings are repatriated, unless there is an assumption that these earnings are indefinitely reinvested. However, there is a disparity in practice as to how U.S. MNCs interpret whether the earnings of foreign subsidiaries are indefinitely reinvested.

Most U.S. MNCs assume a very high percentage of their low-taxed unrepatriated foreign earnings are indefinitely reinvested, whereas some assume substantial portions are not indefinitely reinvested. For example, Apple only assumes approximately 50 percent of its low-taxed foreign earnings are indefinitely reinvested even though they show no sign of repatriating their foreign earnings anytime soon. As a result, Apple’s reported ETR is substantially higher than if 100 percent of their foreign earnings were considered indefinitely reinvested.

Thus, when comparing ETRs across companies, it may be useful to strip out the increase in ETR attributable to deferred tax expense recorded for the unremitted earnings of foreign subsidiaries. Furthermore, when examining the trend in the ETR, it should be noted that a reduction in the ETR over the years may in fact be due to income shifting to foreign jurisdictions.

B. Large Unrecognized Tax Benefits

Although disclosure of $7 billion of total unrecognized tax benefits (UTBs) may earn a corporation the top spot on the Ferraro 500 list of uncertain tax positions, the more important indicator of corporate tax aggressiveness is total UTBs relative to the size of a corporation (e.g., as a percentage of equity or assets).

C. Permanent versus Temporary UTBs

FIN 48 requires disclosure of the portion of UTBs that, if recognized, will impact the ETR. This effectively asks what portion of the UTBs relates to permanent differences.

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15 The total ETR is defined as total income tax expense divided by worldwide pre-tax income. This is usually the ETR disclosed in a company’s tax footnote and includes both current and deferred tax expenses, as well as all state, federal, and foreign income-based taxes.

16 In 2013 Apple announced that it would borrow approximately $17 billion to fund distributions to shareholders rather than repatriating their foreign earnings. Apple made a similar announcement in April 2014 when announcing another $17 billion debt offering.

17 This amount is either directly disclosed in the tax footnote, or can usually be determined by reviewing the deferred tax asset/liability table and reviewing the increase in the deferred tax liabilities (DTL) attributable to unremitted foreign earnings. However, it is possible that some of the increase in DTL could be attributable to an acquisition.

18 It is possible that in certain limited circumstances that a temporary difference could lead to an impact on the ETR, but this is rare.
For example, if Corporation A has $6 billion of UTBs and they all relate to permanent differences, while Corporation B also has $6 billion of UTBs but they relate to temporary differences, most observers should conclude that Corporation A has more tax risk than Corporation B. Thus, one additional indicator of corporate tax aggressiveness is the percentage of UTBs that are permanent rather than temporary.

D. Increases in UTBs Related to the Current Year

Since FIN 48 does not require disclosure of the cumulative UTBs by tax jurisdiction, it is very difficult to compare whether Corporation A is more or less aggressive than Corporation B, as well as whether a specific corporation is becoming more or less aggressive when compared to prior years. For example, Corporation A may have $1 billion of UTBs but have six open years with the IRS, anywhere between three to six open years with various state tax authorities, and up to 10 open years with various foreign jurisdictions. Corporation B may also have $1 billion of UTBs but radically different open years. Since the $1 billion of UTBs is not allocated between various tax jurisdictions, it is impossible to determine an average UTB by year for specific tax jurisdictions.

Fortunately, one of the reconciling items in the tabular roll-forward of UTBs is a disclosure of the increase in UTBs applicable to the current year. The increase in UTBs attributable to the current year can be very useful in estimating how aggressive a corporation is with respect to a specific year’s tax positions for all tax jurisdictions. For example, one could analyze the trend in this amount in absolute dollars, but also relative to various measures of size (e.g., pre-tax income, revenue, equity, or assets).

E. Indicators of Income Being Shifted to Low-Tax Jurisdictions

As described in Section IV, many U.S. MNCs are shifting income to low-tax foreign jurisdictions. When reviewing a U.S. MNC’s financial statements, there are several potential indicators of income shifting, including:

The Amount of U.S. and Foreign Pre-tax Income Relative to Other Measures of Activity. Public corporations typically disclose in their tax footnote the U.S. and foreign components of pre-tax income from continuing operations. They also usually disclose somewhere in their Form 10-K U.S. and foreign employees and/or compensation expense, and U.S. and foreign sales revenue. If the indicia of activity (i.e., employees, compensation expense, or sales) are radically different than the ratio of U.S. to foreign pre-tax income, this can be an indicator of income shifting. For example, in 2011 Apple had only 30 percent of its pre-tax income in the United States, but had 67 percent of its employees, 79 percent of its compensation expense, and 39 percent of its sales in the United States (Harvey, 2013a).

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19 Other reconciling items relate to prior years and are very difficult to interpret. However, if a corporation is either consistently releasing or adding to its net reserves for prior years, it can say something about the corporation’s tax reserve philosophy (e.g., possibly a propensity to either overstate or understate initial tax reserves).

20 Although there can be issues as to how these data are accumulated (e.g., by the location of legal entity versus some other approach), they are the best available data.
Very Low Foreign ETR. Given that the United States has the highest corporate tax rate in the OECD, one would expect a corporation’s U.S. ETR to typically be higher than its foreign ETR.\(^{21}\) However, an exceedingly low foreign ETR (i.e., less than 15 percent to 20 percent), is indicative that foreign pre-tax income is likely located in a low-tax jurisdiction. For example, Apple’s 2011 foreign ETR was only 2.5 percent (Harvey, 2013a).

Cumulative Unremitted Earnings from Foreign Subsidiaries. Certain U.S. MNCs have huge amounts of unremitted earnings from foreign subsidiaries. For example, on December 31, 2013, General Electric had $110 billion of cumulative unremitted foreign earnings that are indefinitely reinvested. However, similar to the discussion of UTBs above, the absolute size of the unremitted earnings is not as important as their size relative to the corporation’s overall size (e.g., equity or assets), or the growth in unremitted earnings as a percentage of total pre-tax income or foreign pre-tax income.

In summary, although there may be other indicators of corporate tax aggressiveness, the above list includes the ones that have generally been most useful during my career.

VI. REVIEW OF FINANCIAL STATEMENT DATA FOR SELECTED CORPORATIONS

Although the primary purpose of this article is to describe my perceptions of corporate tax aggressiveness over the past 15 to 20 years, selected data was collected and analyzed from the top 21 companies listed on the 2013 version of the Fortune 500.\(^ {22}\) The data collected included: UTB-related data from inception of FIN 48 (i.e., 2006 through 2012/2013), and other data from 2004 to 2012/2013.\(^ {23}\) The UTB data included total UTBs, the percentage of UTBs that if recognized would impact the ETR, and the gross increase in UTBs for the specific year. Other data included pre-tax income and expense on continuing operations, the allocation of pre-tax income between U.S. and foreign sources, the amounts of indefinitely reinvested foreign earnings, and the amounts of shareholder equity. Section V.A summarizes the aggregate data, and Section V.B summarizes selected data by corporation.

A. Analysis of Aggregate Data

Tables 1 and 2 summarize selected aggregate data from the 21 companies. Four key points can be observed in these data.

\(^{21}\) The foreign ETR is defined as foreign income tax expense divided by foreign pre-tax income.

\(^{22}\) See Table 3 for a list of the corporations selected. The Fortune 500 ranks corporations by revenue ("Fortune 500, 2013," Fortune Magazine, http://money.cnn.com/magazines/fortune/fortune500/2013/full_list/index.html?id=F500_sp_full). Note that with the exception of General Motors, the first 22 corporations on the list were selected for my sample. General Motors was not selected because it declared bankruptcy in 2009 and the data pre- and post-bankruptcy were not considered consistent. Resource constraints limited the analysis to only 21 corporations. I hope that others with access to extensive databases could analyze more corporations.

\(^{23}\) Of the 21 companies, 17 had UTB data for eight years (i.e., 2006 to 2013), but four companies had fiscal years that only allowed collection of information for seven years (i.e., FIN 48 was only effective for taxable years beginning after December 15, 2006).
First, although total UTBs have increased since the inception of FIN 48, they have decreased as a percentage of equity. This could be an indication that companies are being less aggressive, or at least in the aggregate are not increasing their overall tax aggressiveness. Another possibility is that planning has transitioned to strategies such as profit shifting to foreign jurisdictions for which corporations do not believe they need a material tax reserve.

Second, permanent UTBs as a percentage of total UTBs have increased fairly significantly from 2006 to 2012. This is consistent with the theory that U.S. MNCs are being more aggressive at shifting income to low-tax jurisdictions (i.e., the tax reserve recorded for shifting income should normally be a permanent item).

Third, indefinitely reinvested earnings as a percentage of equity has increased significantly. This result is also consistent with significant income shifting. It also could possibly explain why U.S. MNCs are lobbying for either another tax holiday or a territorial tax system. The bottom line is it is becoming substantially more difficult for U.S. MNCs to run their operations when they have shifted so much of their income overseas and need the resulting cash back in the United States to pay dividends, fund stock buy-backs, or just to finance U.S. operations. For example, although Apple recently announced it will once again borrow about $17 billion to fund its dividend and share buybacks instead of repatriating cash, eBay has in contrast announced that it will eventually repatriate $9 billion for future U.S. needs.

Fourth, foreign pre-tax income was relatively stable during the financial crisis, but US pre-tax income decreased substantially. Again, this is consistent with the shifting of

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Table 1
Aggregate Data on Unrecognized Tax Benefits (UTBs)

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<tr>
<td>Total UTBs ($billion)</td>
<td>53</td>
<td>50</td>
<td>50</td>
<td>52</td>
<td>48</td>
<td>43</td>
<td>40</td>
</tr>
<tr>
<td>Total UTBs/Equity (%)</td>
<td>3.1</td>
<td>3.1</td>
<td>3.3</td>
<td>3.8</td>
<td>3.9</td>
<td>3.4</td>
<td>3.5</td>
</tr>
<tr>
<td>Permanent UTBs/Total UTBs (%)</td>
<td>58</td>
<td>61</td>
<td>60</td>
<td>60</td>
<td>55</td>
<td>46</td>
<td>n/a</td>
</tr>
<tr>
<td>Increase in UTBs for Current Year ($billion)</td>
<td>6.4</td>
<td>4.3</td>
<td>5.3</td>
<td>5.9</td>
<td>6.0</td>
<td>5.0</td>
<td>n/a</td>
</tr>
<tr>
<td>Increase in UTBs for Current Year/Equity (%)</td>
<td>0.38</td>
<td>0.27</td>
<td>0.35</td>
<td>0.44</td>
<td>0.49</td>
<td>0.40</td>
<td>n/a</td>
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1 This is the increase in UTBs attributable to the current year (i.e., the disclosure required pursuant to FIN 48, paragraph 21.a(2)); see Section IV.D.

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24 Another explanation is that the decline in UTBs as a percentage of equity could be caused by companies recording fewer tax reserves because of the transparency resulting from FIN 48 and Schedule UTP, although presumably the company’s external auditors would have prevented companies from materially understating their total UTBs. Alternatively, it may be that U.S. MNCs experienced generally higher rates of growth in the equity component of their financial statements, reflecting the economic recovery since 2009, rather than greater growth in aggressive tax planning over that same period.
Table 2
Aggregate Data on the Shifting of Income

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<tr>
<td>Indefinitely reinvested earnings/Equity (%)</td>
<td>24</td>
<td>24</td>
<td>20</td>
<td>20</td>
<td>21</td>
<td>17</td>
<td>15</td>
<td>13</td>
<td>12</td>
</tr>
<tr>
<td>Increase in indefinitely reinvested earnings/Foreign pre-tax income (%)</td>
<td>16</td>
<td>37</td>
<td>25</td>
<td>13</td>
<td>25</td>
<td>28</td>
<td>33</td>
<td>18</td>
<td>n/a</td>
</tr>
<tr>
<td>Foreign pre-tax income/Total pre-tax income (%)</td>
<td>51</td>
<td>61</td>
<td>58</td>
<td>88</td>
<td>92</td>
<td>50</td>
<td>49</td>
<td>44</td>
<td>44</td>
</tr>
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</table>
substantial pre-tax income to foreign locations (i.e., the negative impact of the financial crisis in foreign subsidiaries was offset by the shifting of income from the United States).

Although not dispositive, this data is consistent with the subjective observation that U.S. MNCs may have curtailed much of their aggressive tax planning strategies, while increasing the shifting of income to low-tax foreign jurisdictions. Specifically, when considering that overall UTBs are only increasing modestly in absolute terms, and decreasing as a percentage of equity, the data is consistent with the theory that corporations in general have become less aggressive over the past decade for the reasons summarized in Section III.B. However, to reach a definitive conclusion, further research is likely needed by those that are much better statisticians than this author.

B. Analysis of Individual Corporation Data

Table 3 summarizes selected data from the 21 corporations. Four key facts are apparent in the data.

First, IBM, Hewlett Packard, and General Electric have indefinitely reinvested earnings that are in excess of 80 percent of equity (228 percent in the case of IBM). These companies may have serious liquidity issues to the extent foreign earnings are needed to fund dividends and stock buy-backs by the U.S. parent company, or to fund U.S. expansion. Their alternatives for funding such needs would be either to repatriate their foreign cash reserves back to the United States and incur a significant U.S. tax liability, or to devise more aggressive and creative ways to get the cash back to the United States tax free. For example, to help finance U.S. operating needs, Hewlett Packard used an aggressive alternating loan strategy to repatriate cash to the United States without incurring U.S. tax.25

Second, Ford, IBM, and Cardinal Health have UTBs that are in excess of 10 percent of shareholder’s equity. These companies could be viewed as potentially being more aggressive than others. Alternatively, they could be viewed as having more upside potential if the UTBs are ultimately recognized. Third, oil companies have very high ETRs, but there is a wide divergence in the percentage of their UTBs that are permanent. For example, Exxon has no permanent UTBs, while for Chevron, Conoco-Phillips, and Valero over 50 percent of total UTBs are classified as permanent. This seems unusual.

Fourth, retailers have relatively high ETRs whereas technology companies (e.g., Apple and Hewlett Packard) have relatively low ETRs. This result is not surprising, given retailers have primarily a U.S. domestic footprint.

VII. POLICY OPTIONS

Assuming that tax policy makers would like to further reduce corporate tax aggressiveness, the general focus should be on increasing the cost to corporations for taking

25 Hewlett Packard’s strategy was the subject of an investigation and hearing by the U.S. Senate (2012).
## Table 3
Selected Data for Individual Corporations

<table>
<thead>
<tr>
<th>Corporation</th>
<th>Average ETR (Percent)</th>
<th>Average UTBs ($Billion)</th>
<th>Average UTBs/Equity (Percent)</th>
<th>Average Permanent UTBs/Total UTBs (Percent)</th>
<th>2013 Indefinitely Reinvested Earnings ($Million)</th>
<th>2013 Indefinitely Reinvested Earnings/2013 Equity (Percent)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Walmart</td>
<td>33</td>
<td>834</td>
<td>1.2</td>
<td>67</td>
<td>21,400</td>
<td>26</td>
</tr>
<tr>
<td>Exxon</td>
<td>41</td>
<td>5,511</td>
<td>3.9</td>
<td>0</td>
<td>47,000</td>
<td>26</td>
</tr>
<tr>
<td>Chevron</td>
<td>43</td>
<td>3,036</td>
<td>2.9</td>
<td>71</td>
<td>31,300</td>
<td>21</td>
</tr>
<tr>
<td>Conoco-Phillips</td>
<td>53</td>
<td>1,052</td>
<td>1.5</td>
<td>67</td>
<td>4,922</td>
<td>7</td>
</tr>
<tr>
<td>Berkshire Hathaway</td>
<td>31</td>
<td>866</td>
<td>0.6</td>
<td>67</td>
<td>9,300</td>
<td>4</td>
</tr>
<tr>
<td>Apple</td>
<td>17</td>
<td>1,292</td>
<td>2.1</td>
<td>42</td>
<td>54,400</td>
<td>44</td>
</tr>
<tr>
<td>General Electric</td>
<td>14</td>
<td>6,214</td>
<td>5.1</td>
<td>60</td>
<td>110,000</td>
<td>81</td>
</tr>
<tr>
<td>Valero</td>
<td>38</td>
<td>374</td>
<td>2.2</td>
<td>52</td>
<td>3,500</td>
<td>18</td>
</tr>
<tr>
<td>Ford</td>
<td>&lt;0</td>
<td>1,578</td>
<td>34.4</td>
<td>53</td>
<td>7,500</td>
<td>28</td>
</tr>
<tr>
<td>AT&amp;T&lt;sup&gt;3&lt;/sup&gt;</td>
<td>n/a</td>
<td>5,108</td>
<td>4.9</td>
<td>51</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>Fannie Mae</td>
<td>42</td>
<td>716</td>
<td>8.8</td>
<td>2</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>CVS</td>
<td>39</td>
<td>108</td>
<td>0.3</td>
<td>58</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>McKesson&lt;sup&gt;2&lt;/sup&gt;</td>
<td>30</td>
<td>557</td>
<td>8.2</td>
<td>58</td>
<td>3,800</td>
<td>54</td>
</tr>
<tr>
<td>Hewlett Packard</td>
<td>19</td>
<td>2,393</td>
<td>6.7</td>
<td>42</td>
<td>38,200</td>
<td>138</td>
</tr>
<tr>
<td>Verizon&lt;sup&gt;1&lt;/sup&gt;</td>
<td>n/a</td>
<td>2,907</td>
<td>3.8</td>
<td>55</td>
<td>2,100</td>
<td>2</td>
</tr>
<tr>
<td>United Health</td>
<td>36</td>
<td>211</td>
<td>0.8</td>
<td>48</td>
<td>359</td>
<td>1</td>
</tr>
<tr>
<td>J.P. Morgan Chase</td>
<td>29</td>
<td>6,205</td>
<td>3.7</td>
<td>47</td>
<td>28,500</td>
<td>13</td>
</tr>
<tr>
<td>Cardinal Health&lt;sup&gt;2&lt;/sup&gt;</td>
<td>39</td>
<td>713</td>
<td>10.6</td>
<td>50</td>
<td>1,800</td>
<td>30</td>
</tr>
<tr>
<td>IBM</td>
<td>26</td>
<td>4,399</td>
<td>19.7</td>
<td>83</td>
<td>52,300</td>
<td>228</td>
</tr>
<tr>
<td>Bank of America</td>
<td>27</td>
<td>3,834</td>
<td>1.9</td>
<td>67</td>
<td>17,000</td>
<td>7</td>
</tr>
<tr>
<td>Costco&lt;sup&gt;2&lt;/sup&gt;</td>
<td>35</td>
<td>95</td>
<td>0.9</td>
<td>30</td>
<td>3,619</td>
<td>33</td>
</tr>
</tbody>
</table>

Notes: The average ETR for the period 2004 to 2012/2013 equals total income tax expense divided by total pre-tax income. However, in the case of Apple and Hewlett Packard, modified ETRs for the period 2005 to 2012 are calculated to exclude deferred U.S. tax expense on unrepatriated foreign earnings. The average UTBs are for the period 2006 to 2012/2013. Average UTBs divided by equity equals total UTBs for the period 2006 to 2012/2013 divided by total equity for the period 2006 to 2012/2013.

<sup>1</sup>In 2012, Conoco Phillips split into two companies (i.e., Conoco and Phillips 66). In order to maintain comparability, the results of Conoco and Phillips 66 were combined for 2012 and 2013 and analyzed with Conoco Phillips for 2011 and prior years.

<sup>2</sup>These companies had fiscal years that prevented the accumulation of 8 years of UTB information (i.e., 2006 to 2013) and 10 years of other information (i.e., 2004 to 2013). Thus, fiscal year information was collected for 7 and 9 years.

<sup>3</sup>Both AT&T and Verizon had substantial restatements during the period that makes it difficult to analyze their effective tax rate.
an aggressive tax position.\textsuperscript{26} The cost to corporations could be increased through greater transparency and an increase in tax penalties. Several possibilities are discussed below.

\section*{A. Improve the Functioning of the IRS Whistleblower Program}

As summarized in the Fiscal Year 2013 IRS Whistleblower Report to Congress (IRS, 2013), the number of whistleblower claims the IRS received after the enactment of IRC 7623(b) in 2006 is staggering. Although many of these whistleblower claims relate to individuals, many also relate to corporations.\textsuperscript{27}

As discussed previously, the mere existence of the IRS whistleblower program provides some deterrent to corporate tax aggression, but a fully functioning program could be quite powerful. Unfortunately, the IRS whistleblower program is not working as well as it should. For example, there have been over 2,300 whistleblower claims since the inception of IRC 7623(b) in 2007, but only nine payments (IRS, 2013).

Although some of this apparently low success rate is explained by the need for the IRS to collect funds before a whistleblower can be paid, there are likely several additional problems with the current program that could impact the willingness of future corporate whistleblowers to volunteer information. For example, the IRS may not have the resources to investigate all serious claims or IRS agents may argue they have sufficient information without the whistleblower’s information when in reality they do not. In addition, the whistleblower’s confidentiality is not guaranteed and there is a long period of time before a whistleblower is paid for a claim (i.e., the IRS needs to collect money first, which usually does not occur until after all taxpayer appeal rights have been exhausted). Finally, the IRS and Treasury have taken various positions that reduce payouts to whistleblowers.\textsuperscript{28}

If these problems could be adequately addressed, the IRS could improve its ability to attack corporate aggressiveness. The IRS whistleblower program is a major potential tool for curbing the most aggressive corporate tax planning, but unfortunately it is currently not operating anywhere near its full potential.

\section*{B. Make Improvements to Schedule UTP}

Although Schedule UTP has the potential to be very valuable to the IRS, it is still unclear whether Schedule UTP will ultimately be successful. One important issue is

\textsuperscript{26} In addition, the tax law could also be changed to make it more difficult to shift income out of the United States and therefore reduce the benefit to corporations. This approach is not considered in this paper but is discussed in Harvey (2013a).

\textsuperscript{27} This assertion is based upon the author’s experience while a senior IRS official.

\textsuperscript{28} For example, see June 15, 2014 comment to the US Treasury Department by the National Whistleblowers Center available at http://whistleblowers.nonprofitsoapbox.com/storage/whistleblowers/docs/BlogDocs/irsrulecomment.pdf.
that loopholes in Schedule UTP may allow aggressive corporations to avoid disclosure; Harvey (2013b) provides a more complete description of the potential loopholes and offers several recommendations. For example, the IRS should adopt a carrot-and-stick approach, whereby the IRS agrees to not pursue tax accrual workpapers (TAWs) for a tax issue if the tax issue is adequately disclosed on Schedule UTP. If the tax issue is not adequately disclosed, the IRS should aggressively pursue all TAWs. Given this trade-off, I believe that substantially all tax directors would agree to accurately complete Schedule UTP. In addition, it must be made clear that any recorded reserve must be disclosed on Schedule UTP, even if the reserve is not material to the financial statements as a whole. Finally, Schedule UTP should be audited by a corporation’s external auditor.

It is also far from clear whether the IRS is effectively using Schedule UTP information. In response to the uproar from corporate America over Schedule UTP, the IRS has understandably taken a cautious approach to implementation. Nevertheless, given that Schedule UTP has now been in existence for approximately four years, the IRS should make sure they are fully utilizing its potential.

In summary, Schedule UTP has the potential to be a very valuable tool for the IRS, but it may not be fulfilling its potential as the “the biggest change in tax administration in the last 50 years.”

C. Improve Transparency Surrounding the Shifting of Income to Tax Havens

Given that MNCs (both U.S. and foreign) are being very aggressive at shifting income to low-tax foreign jurisdictions, it is imperative that tax authorities around the world obtain increased transparency surrounding this activity. Fortunately, the OECD is actively pursuing country-by-country reporting and the EU has implemented country-by-country reporting for certain financial institutions (Ernst and Young LLP, 2014).

Some might ask why country-by-country reporting is needed. In short, my experience is that without such reporting, many tax auditors will have difficulty identifying the appropriate issues to audit. For example, when preparing to give expert testimony at the May 2013 Apple hearing, it quickly became clear I needed a country-by-country analysis to identify the overall picture of Apple’s tax planning.

Although tax auditors could request such information, it would be much better for MNCs and tax auditors if the information were prepared in a consistent format at the time the return is filed. Country-by-country information should include: (1) consolidated schedules of pre-tax income and tax expense prepared by a legal entity that agree to the consolidated financial statements; (2) taxable income and tax liability reported to a country by each legal entity (or entities filing a combined return); (3) indicia of activity in a legal entity (or entities filing a combined return) by country, including the number of employees, compensation expense, sales by location of customer, tangible assets, and amounts of passive income such as interest and royalties.
For purposes of the above information, “disregarded” entities, such as those created by “check the box” elections, would be respected as the true legal entities in order to obtain a more accurate and comprehensive picture of the worldwide activity of a MNC. In order to protect confidential information and proprietary business practices, country-by-country information should only be available to tax authorities. However, I would not rule out making some or all of the above information public in the future. Public disclosure of country-by-country information could increase a MNC’s reputation risk and therefore deter overly aggressive shifting of income.

D. Increase Penalties for Taking Aggressive Tax Positions

All of the proposals in Sections VI.A–C are aimed at altering a corporation’s cost benefit/analysis by increasing transparency and therefore making it more likely that a tax authority will discover there is an issue. If U.S. tax policy makers want to further alter a corporation’s cost/benefit analysis, they may want to consider modifying the substantial understatement penalty. Currently, if a corporation understates its tax liability by certain thresholds, it can be liable for a 20 percent substantial understatement penalty, and up to a 40 percent penalty for gross valuation misstatements, including those relating to the Section 482 transfer pricing rules. However, the penalty may be avoided if a corporation has substantial authority for the tax position, or the tax position is disclosed to the IRS and has at least a reasonable basis for the position.\(^{29}\) For corporate tax shelters, a corporation generally needs a more-likely-than-not level of comfort to avoid a substantial understatement penalty.

In particular, tax policy makers should consider requiring tax return disclosure of all uncertain tax positions to avoid a penalty (i.e., eliminate a corporation’s ability to argue they either had substantial authority or a more-likely-than-not level of comfort surrounding a tax position). Alternatively, they could eliminate the substantial authority exception to the substantial understatement penalty (i.e., require at least a more-likely-than-not level of comfort).

In addition, in order to avoid a penalty, corporations should be required to disclose a tax issue to the IRS and be prepared to defend it. One potential problem with this alternative is that corporations may deluge the IRS with disclosures. In order to minimize the impact of this possibility, corporations should be required to disclose the dollar amount of the uncertainty so the IRS can focus on high dollar issues and issues related to tax haven countries if it so chooses.

Finally, the IRS could impose a strict liability penalty that is applicable if a corporation understates its tax liability by a certain dollar or percentage amount, for any reason. This penalty should be applied automatically, without potential reduction due to mitigating

\(^{29}\) See Internal Revenue Code (IRC), Section 6662.
factors. Although such a proposal would surely upset corporations, it could impact their cost/benefit analysis, especially when coupled with increased transparency.

VIII. SUMMARY

Aggressive corporate tax planning has existed throughout history and will likely continue for as long as corporations are subject to tax. However, the degree of corporate tax aggressiveness can ebb and flow depending upon the legal environment and whether corporations believe the benefits exceed the costs.

During the 1990s and early 2000s, many corporations pursued very aggressive tax positions. However, starting in the early 2000s several factors have likely altered the cost-benefit analysis surrounding aggressive corporate tax planning, including:

- The enactment of Sarbanes-Oxley;
- Increased transparency through reportable transactions, Schedule M-3, Schedule UTP, and FIN 48;
- The IRS whistleblower program;
- Increased reputational risk resulting from news articles, reports by non-governmental organization, accusations by whistleblowers, and high profile government hearings;
- IRS success in winning several economic substance cases; and
- Successful litigation against tax shelter promoters (KPMG, E&Y, Jenkins and Gilchrist, etc ...).

As a result, corporations are generally less tax aggressive in 2014 than they were during the 1990s and early 2000s. However, there is one major exception: multinational corporations have become more aggressive in shifting taxable income from high-tax to low-tax jurisdictions through aggressive transfer pricing and/or creative tax structures.

Assuming policy makers desire to reduce corporate tax aggressiveness, Section VII of the paper also discusses several additional options that could be considered, including:

- Improving the functioning of the IRS whistleblower program;
- Making improvements to Schedule UTP;
- Improving transparency surrounding the shifting of income to tax havens; and
- Increasing penalties for taking aggressive tax positions.

All of these proposals are aimed at reducing tax aggressiveness by altering a corporation’s cost-benefit analysis surrounding aggressive transactions.
ACKNOWLEDGEMENTS

I would like to thank (1) my Research Assistant, Katie Duquette, for her assistance in accumulating financial statement information for the 21 companies analyzed, and in general, her helpful comments on this paper; (2) Bob Duquette, Adjunct Professor at Lehigh University, for his very insightful comments; and (3) George Plesko, Associate Dean at University of Connecticut School of Business, for his very helpful edits and formatting suggestions.

DISCLAIMERS

Any mistakes and views expressed are solely my own.

DISCLOSURES

I have no financial arrangements that would give rise to a conflict of interest in preparing this paper.

REFERENCES


