When board members get involved, corporate tax burden goes down

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Credit: Benjamin Child.

New research finds that corporate tax-planning practices improve when a company's board takes an interest in tax-planning practices—and better planning results in both less tax uncertainty and a lower tax burden.

"We wanted to see what happens when board members take an active role in risk oversight for a company's tax-planning efforts—and we

found that it makes a substantial difference to a company's bottom line," says Nathan Goldman, co-author of a paper on the work and an assistant professor of accounting in North Carolina State University's Poole College of Management.

"For example, risk oversight of tax planning in an international business context might include the board playing an active role in determining the location of a new subsidiary and helping to consider the tax implications of the new location—as well as any related non-tax risks."

For this study, researchers evaluated the activities of 665 publicly traded companies to determine the extent of each board's involvement in risk management. The researchers also evaluated financial reporting of income taxes to gain insights into each company's tax-planning practices.

"We estimate that companies with the highest level of risk oversight have 31% lower tax uncertainty and 13.2% lower tax burden, as compared to the companies with the lowest level of risk oversight," Goldman says.

Tax uncertainty is the risk that the IRS or another taxing authority will overturn a company's tax position, resulting in the company having to pay back the money it saved from the tax positions—as well as penalties.

"A good tax-planning strategy is one that results in substantial tax savings and does not subject the firm to other risks or unexpected future tax liabilities," Goldman says.

"In the context of international tax planning, a good, low-risk decision might be to open a new manufacturing facility in a low-tax-rate jurisdiction—such as Ireland. This strategy would allocate more income to the low-tax country, but should not create a risky tax position that would be overturned by the IRS.

"In contrast, a bad, high-risk decision would be to just set up a shell company and make journal entries to artificially allocate income without a substantial business purpose. This strategy may result in the firm being shamed in the news for shifting income abroad, resulting in reputational harm. It could also result in the IRS reallocating income to the United States, resulting in higher tax payments, plus interest and penalties.

"Ultimately, our study suggests that companies are more likely to make high-risk decisions when the board is not involved," Goldman says. "And more likely to make decisions that balance risk and reward when the board is involved. So there are excellent reasons for board members to include tax planning in their enterprise risk management efforts."

More information: Mark, S Beasley et al, Board Risk Oversight and Corporate Tax-Planning Practices, *Journal of Management Accounting Research* (2020). DOI: 10.2308/JMAR-19-056

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