Companies that are aggressive on taxes fall short at managing their workforce

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A new study finds companies that are more aggressive in their tax planning tend to do a worse job of managing their workforce. Specifically, these companies were more likely to be "underemployed," meaning they hadn't hired enough staff to operate efficiently.

"Aggressive tax planning means a company will have more cash on hand, so it should be able to invest more in its workforce," says Nathan Goldman, co-author of a paper on the work and an assistant professor of accounting at North Carolina State University. "We wanted to know if this was actually playing out in the real world. As it turns out, companies that engage in aggressive tax planning are actually doing a worse job of investing in labor—and that has ramifications for their overall operating efficiency."

Labor investment efficiency is when a company has the amount of workers it needs. If it needs 10 workers, and it has nine, then it is underemployed—and won't have enough people to do all of its work. If it has 11 employees, then it is overemployed—and won't have enough work to support its workforce.

To look at the relationship between tax planning and labor investment, the researchers collected data from 3,610 publicly traded U.S. companies. Specifically, they collected data from a total of 21,345 annual reports from those companies.

To assess how aggressive each company's tax planning was, the researchers looked at the amount of tax each company paid relative to its profit. The less tax it paid, the more aggressive the company's tax planning was.

To assess labor efficiency, the researchers looked at a variety of factors—such as sales growth, overall company assets, and the number of people hired in a given year.

"For example, if a company's sales declined, you would expect hiring to decrease," Goldman says. "But we looked at quite a few variables here, so calculations of labor efficiency were actually quite a bit more complicated than that.

"The short version of our finding is that companies engaged in aggressive tax planning didn't do a good job of hiring to meet their workforce needs," Goldman says.

Here's why.

Aggressive tax planning requires companies to embrace a certain amount of uncertainty. For example, there's always the possibility a company will be audited and have to pay more in taxes and fines than it anticipated. Similarly, there are indirect risks, such as facing public relations or political challenges as a result of paying too little in taxes.

"Our study strongly suggests that the risks and uncertainties associated with aggressive tax planning make firms more cautious about engaging in long-term investments, such as hiring," Goldman says.

These findings were strongest among firms that took on greater tax risk, higher labor costs and weaker corporate governance. Companies with "weaker corporate governance" are subject to less institutional oversight, and garner less attention from external analysts, than their peers.

"Ultimately, the take-away message for business leaders is that they need to think about whether aggressive tax strategies ultimately benefit the company," Goldman says. "If those tax strategies mean a company is not investing efficiently in its workforce, that could hurt the company's bottom line. Basically, is the labor inefficiency costing the company more than it saved in taxes?"

The paper, "Aggressive Tax Planning and Labor Investments," is published in the *Journal of Accounting, Auditing & Finance*. First author of the paper is Simone Traini of the Norwegian School of Economics. The paper was co-authored by Christina Lewellen, an assistant professor of accounting at NC State.

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