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Study Examines How U.S. Companies' Overseas Employees Offer Them U.S. Tax Benefits

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U.S. corporations with a high percentage of employment in foreign countries experience more tax benefits, according to a study forthcoming in The Accounting Review.

In an article titled "Foreign Employment, Income Shifting, and Tax Uncertainty" researchers analyzed the relation between the location of employees at large U.S. multinational companies and income shifting activities, a particularly aggressive form of tax planning. The article is authored by Katharine Drake of the University of Arizona, Nathan Goldman from North Carolina State University, and Frank Murphy of the University of Connecticut.

“We were interested in how tangible investments, such as employment, affect tax planning activities. Companies like Caterpillar have recently been scrutinized by Congress over whether their employees' location aligns with where they report their income. We were interested in understanding these companies’ tax benefits,” says Goldman.

In the study, the researchers describe how U.S. multinational companies can differ in where they place employees and how this can alter tax planning opportunities. For example, a company with employees in the U.S. and France has different opportunities and incentives to shift income than a company with employees in the U.S., France, Ireland, and a tax haven country like the Cayman Islands.

The research team used financial statement disclosures of employment information to create a sample of 6,641 observations across 815 unique large U.S. multinational companies. Using this information, they determined whether companies had higher or lower foreign employment relative to their foreign operations.

For those companies with more foreign employment, they found that these companies shifted more income out of the U.S. The study estimates that companies with higher than expected foreign employment shift $69 billion more in income out of the U.S. than companies with lower foreign employment.

“We find that taxes must be a consideration as companies globalize. Sure, there are non-tax considerations that may be the driving factors on where and to what extent companies expand into new countries. However, our findings suggest that there are significant tax benefits associated with having employees in these lower-taxed countries, and these benefits must be considered when assessing the viability of such a large investment,” advises Goldman.

The study then considers how foreign employment is related to tax uncertainty, or the likelihood a company must reserve for its aggressive tax planning activities in its financial statements. It finds that companies with high foreign employment have less tax uncertainty related to their foreign operations than those with less foreign employment.

“The IRS can overturn tax positions lacking economic substance. Our findings suggest that companies can use foreign employment to generate that economic substance, validating their aggressive tax planning activities in the eyes of the IRS,” says Goldman.

Goldman concludes, “Recent tax reforms, like the Tax Cuts and Jobs Act of 2017, place an even greater emphasis on having economic substance for multinational tax planning. Our study suggests that tax benefits generated from shifting income from a high tax to a lower tax jurisdiction and incurring lower tax uncertainty while doing so can be meaningful factors as companies continue their overseas expansion. And, for companies already overseas, they should evaluate whether there are opportunities available to them to generate these benefits that they are not already using.”

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