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International Corporate Tax Avoidance Practices: Evidence from Australian Firms

Grantley Taylor [a, 1], Grant Richardson [b,*]

[a] *School of Accounting, Curtin Business School, Curtin University, GPO Box U1987, Perth, Western Australia 6845, Australia*

[b] *Discipline of Accounting and Information Systems, Business School, The University of Adelaide, 10 Pulteney Street, Adelaide, South Australia 5005, Australia*

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Abstract

This paper examines the international corporate tax avoidance practices of publicly listed Australian firms. Based on a hand-collected sample of 203 publicly listed Australian firms over the 2006–2009 period (812 firm-years), our regression results indicate that there are several practices Australian firms use to aggressively reduce their tax liabilities. Specifically, we find that thin capitalization, transfer pricing, income shifting, multinationality, and tax haven utilization are significantly associated with tax avoidance. In fact, based on the magnitude and significance levels of the regression coefficients in our study, thin capitalization and transfer pricing represent the primary drivers of tax avoidance, whereas income shifting and tax haven utilization are less important. Finally, our additional regression results show that tax havens are likely to be used together with thin capitalization and transfer pricing to maximize international tax avoidance opportunities via the increased complexity of transactions carried out through tax havens.
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* Corresponding author. Tel.: +61 8 8313 0582; fax: +61 8 8223 4782.
E-mail addresses: grantley.taylor@cbs.curtin.edu.au (G. Taylor), grant.richardson@adelaide.edu.au (G. Richardson).
[1] Tel.: +61 8 9266 3377; fax: +61 8 9266 7196.

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1. Introduction

International corporate tax avoidance[2] is entrenched within the corporate culture of many western economies (Braithwaite, 2005; Desai, Foley, & Hines, 2006; Rego, 2003; Slemrod, 2001). The practice involves taking advantage of gaps or loopholes in tax legislation to reduce corporate tax significantly (Braithwaite, 2005; Killaly, 2009). Moreover, international tax avoidance arrangements may be structured and included in a firm's overall commercial arrangements (Hamilton, Deutsch, & Raneri, 2001). We are thus motivated in this study to examine whether publicly listed Australian firms make use of opportunities, methods, and tools in relation to thin capitalization, transfer pricing, income shifting, multinational operations and tax haven incorporated entities to significantly avoid paying corporate taxes. We are further motivated to examine the corporate tax avoidance practices of publicly listed Australian firms due to the nature and extent of tax avoidance activity detected during Australian Taxation Office (ATO) audits of these firms. Over our study period from 2006 to 2009, the ATO (sometimes with other tax authorities) audited or reviewed the financial accounts of 35 out of our total of 203 (17.24%) sample firms. Our study provides some unique insights into how publicly listed Australian firms engage in corporate tax avoidance through international activities.

Tax authorities around the world have recognized that international tax avoidance has been contributing to a progressive erosion of tax revenue as evidenced by the decline in corporate effective tax rates (ETRs) and the increase in the number of firms reporting a zero tax liability (ATO, 2010). Some of the main reasons attributed to the zero reported tax liabilities of firms were the abuse of transfer pricing rules and the use of tax havens. For instance, the U.S. Government Accountability Office (GAO, 2008a) observed that over the 1998–2005 period, 24% of U.S controlled corporations and 34% of foreign-controlled corporations reported zero tax liabilities. The major reasons behind the zero reported tax liabilities in the U.S. include the abuse of transfer pricing rules and the utilization of tax havens. The U.S. GAO (2008b) also found that in 2007, 83 out of the 100 largest publicly listed U.S. firms (83%) have subsidiaries in jurisdictions listed as tax havens.

In Australia, the flow of funds to and from tax havens is substantial. For example, in the period from 2005 to 2006, around AUD$8.3 billion (AUD$4.9 billion) flowed from (to) tax havens to (from) Australia, up from approximately AUD$3.5 billion (AUD $2.2 billion) in the 2002 year (ATO, 2010). Moreover, the ATO (2006) found that several Australian firms[3] with significant international dealings had relatively lower profits compared with their market capitalization using industry based comparisons, with amended tax assessments from ATO tax audits resulting in the recovery of in excess of AUD$300 million of corporate taxes. Transfer pricing audits carried out by the ATO from

[2] Consistent with existing accounting research (see, e.g., Frank et al., 2009; Chen, Chen, Cheng, & Shevlin, 2010; Lanis & Richardson, 2012), we define corporate tax avoidance as the downward management of taxable income through tax planning activities. However, we adopt a more aggressive stance with respect to this definition. It encompasses tax planning activities that are considered to be aggressive in that they are designed to actively reduce taxable income by exploiting uncertainties or variability in interpretation of the tax law, taking advantage of areas of the tax law that may fall into the gray area, undertaking arrangements or schemes designed to actively reduce tax liabilities in addition to activities that are illegal.

[3] Undisclosed by the ATO due to privacy constraints.

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