

Chair of Business Taxation

**Activity Report 2014/2015
(01.09.2014–31.08.2015)**



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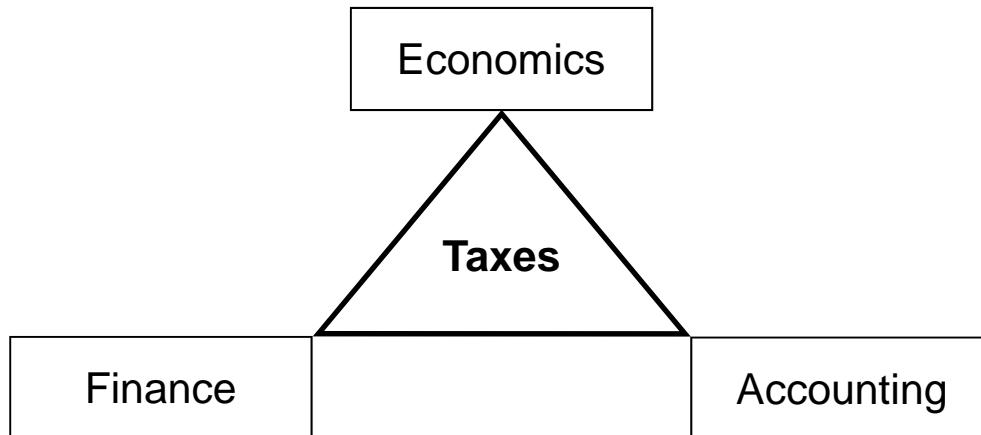
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Editorial

Tax policy has important implications on individual behavior and firm decisions. For example, location decisions of firms, profit shifting of multinationals, capital structure, payout policies, and corporate investments are affected by corporate and individual taxes. Individuals decide on their labor supply, migration, or becoming a business owner. All these decisions are affected by taxes. Taxation is an important aspect when studying economics, finance, and accounting.



The Chair of Business Taxation aims at deepening the understanding of the effects of taxation. The Chair's research and teaching relates to the three subjects economics, finance, and accounting. First, the Chair's research relates to the *economics* literature on individual tax evasion and tax avoidance decisions. Second, teaching and research focus on *finance* topics, for example, the effects of taxes on payout policies and investment policies of firms. Third, the Chair's research focuses on the role of taxes in *accounting*, in particular, on the effect of accounting norms on tax revenues and the valuation relevance of tax accounting.

This report summarizes activities of the Chair of Business Taxation during the academic year 2014/2015.

Martin Jacob

Vallendar, September 2015

Team



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Research Interests:

Determinants of Tax Compliance

Tax Avoidance

International Tax Planning

Empirical Tax Research

Antonio de Vito
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Research Interests:

Corporate Tax Avoidance

Empirical Tax Research

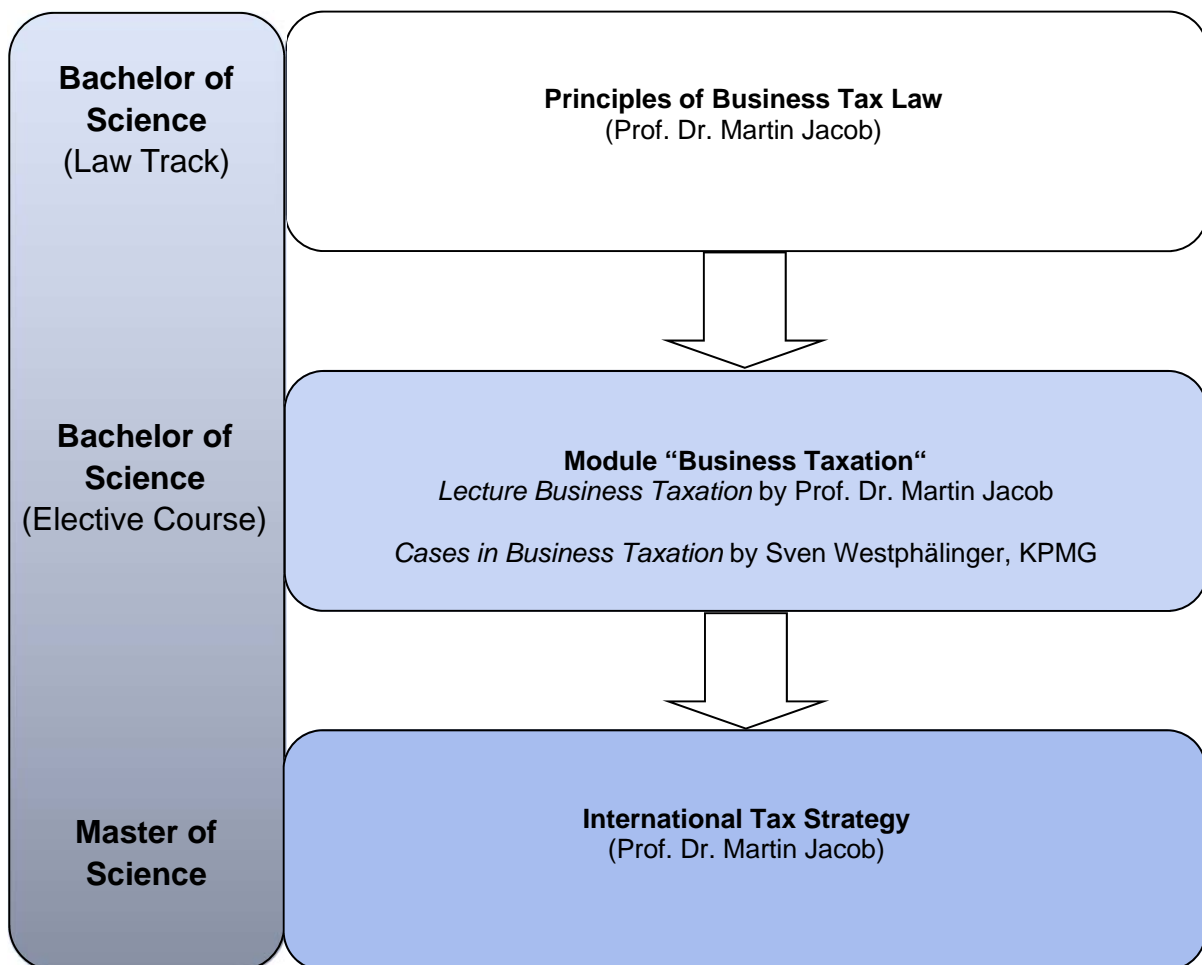


Academic Program

The academic program “Business Taxation“ aims at providing knowledge on how taxes affect business decisions. In collaboration with external lecturers, the chair offers lectures in undergraduate, graduate, and post-experience programs.

In the BSc program, the chair offers one lecture on the principles of business taxation. This course is taught in German and focuses on German tax law. Further, the module “Business Taxation“ combines a lecture on the effects of corporate and individual taxation on business decisions with a case study course.

In the MSc, the chair offers the lecture “International Tax Strategy“ which covers the taxation of globally active companies from a multinational perspective.



Lectures 2014/2015

Fall Term 2014

BSc, Business Taxation

The aim of the module *Business Taxation* is to give an introduction to the topic of taxation of corporations, shareholders, and businesses and to deepen the understanding of how taxes affect business decisions. The course, for example, deals with the tax influence on investment decisions, financing decisions, the choice of organizational form, and mergers and acquisitions. The lecture focuses on concepts that can be applied to different tax systems around the world. To deepen the understanding of these concepts, the second part of the module is based on case studies. After successfully participating in the module *Business Taxation*, participants understand the role of taxes in key business decisions and are able to apply the concepts to practical problems.

Msc, International Tax Strategy

The goal of the module International Tax Strategy is to deepen the understanding of the influence of taxation on multinational companies. The course focuses on taxation of globally active companies from a multinational perspective. It is not necessary to have detailed knowledge of German or any other national tax law. It is the goal of the course to teach critical concepts of international taxation from a global perspective, which are relevant for decision making in multinational companies. The course covers, for example, the treatment of foreign profits, tax treatment of branches and subsidiaries, cross-border financing of companies, anti-avoidance rules, and transfer pricing. The second major focus of the course relates to the economic consequences of international tax rules and how companies react to tax incentive, for example, through international tax planning.

FTMBA Business Tax Strategy

The course focuses on corporate taxes as well as personal income taxation. We discuss practical problems and tax planning integrating all relevant taxes based on case studies. The course covers, for example, tax treatment of partnerships, corporate tax systems, debt versus equity financing, tax treatment of losses, mergers and acquisitions, and basics of international taxation. The course gives a general introduction to tax planning and tax strategy; the course does not require prior tax knowledge of any particular country. It is the goal of the course to provide a general understanding of taxes. The course addresses students interested in general management positions as well as students with a focus on finance, accounting, investment banking, and strategy consulting.

Lectures 2013/2014

Spring Term 2015

BSc, Business Taxation

The aim of the module *Business Taxation* is to give an introduction to the topic of taxation of corporations, shareholders, and businesses and to deepen the understanding of how taxes affect business decisions. The course, for example, deals with the tax influence on investment decisions, financing decisions, the choice of organizational form, and mergers and acquisitions. The lecture focuses on concepts that can be applied to different tax systems around the world. To deepen the understanding of these concepts, the second part of the module is based on case studies. After successfully participating in the module *Business Taxation*, participants understand the role of taxes in key business decisions and are able to apply the concepts to practical problems.

BSc, Principles of Tax Law

The aim of the lecture *Principles of Tax Law* is to give an introduction to German tax law. The course, for example, deals with the personal income tax, the local business tax, and issues of corporate taxation. The lecture focuses on tax law details of Germany and is held in German. After successfully participating in the lecture *Principles of Tax Law*, participants understand the basic concepts of taxation and are able to apply the concepts to practical problems. The lecture *Principles of Tax Law* is the basis for other tax courses on the effects of taxation on business decisions.

Master Theses (2014/2015)

Simone Hemberger

Corporate Tax Incentives and the Location of Holdings in Europe

Maximilian Jensen

Tax Incentives and R&D Investments

Cornelius Korn

The Effect of Corporate Taxation on Investment – Evidence from the EU

Christian von Bernstorff

Tax Sensitivity of Profit Shifting Channels: Evidence from the EU

Dissertation Projects (2014/2015)

Inga Bethmann

Tax Loss Carryback Provisions and Corporate Investments

Antonio de Vito

Essays on Corporate Tax Avoidance

Research

Main Research Areas

Taxation and Investment Decisions

Taxation and Payout Policies

Capital Gains Taxation

Empirical Tax Research

Publications in 2014/2015

Articles in Refereed Journals:

Do Dividend Taxes Affect Corporate Investment?, *Journal of Public Economics*, forthcoming (with Annette Alstadsæter and Roni Michaely).

Dividend Taxes and Income Shifting, *Scandinavian Journal of Economics*, forthcoming (with Annette Alstadsæter).

Self-Serving Bias and Tax Morale, *Economics Letters*, 2015, 131, 91-93 (with Kay Blaufus, Matthias Braune, and Jochen Hundsdoerfer).

Why do Countries Mandate Accrual Accounting for Tax Purposes?, *Journal of Accounting Research*, 2014, 52(5), 1127-1163 (with Igor Goncharov).

New Working Papers:

Taxation and Dividend Policy: The Muting Effect of Diverse Ownership Structure, 2015, SSRN Working Paper (with Annette Alstadsæter and Roni Michaely).

Why do not all firms engage in tax avoidance?, 2015, SSRN Working Paper (with Anna Rohlfing-Bastian and Kai Sandner).

Does Legality Matter? The Case of Tax Avoidance and Evasion, 2015, FAcCT Center Working Paper Nr. 19/2015 (with Kay Blaufus, Matthias Braune, and Jochen Hundsdoerfer).

Tax Policy and Corporate Investments Around the World, 2015, mimeo (with Maximilian A. Müller)

Working Papers 2014/2015

Taxation and Dividend Policy: The Muting Effect of Diverse Ownership Structure (with Annette Alstadsæter and Roni Michaely)

ABSTRACT: Using comprehensive proprietary data on the entire spectrum of ownership structure and exact tax preferences; and utilizing a large exogenous shock to dividend taxation, we show that dividend taxation has a large impact on dividend payout. However, the dividend tax sensitivity gradually decreases as the number of owners increases. Once the firm has four or more owners, the owners' tax preference does not shape the payout policy of the firm. We show empirically that agency frictions such as coordination problems across owners and conflicting objectives of owners and managers as well as heterogeneous tax preferences across owners explain this decrease in tax sensitivity of payout. Taxation has a first order impact on payout policy, but disperse ownership mutes its impact substantially.

Why do not all firms engage in tax avoidance? (with Anna Rohlfing-Bastian und Kai Sandner)

ABSTRACT: Empirical evidence suggests substantial cross-firm variation in the extent of tax avoidance. However, this variation is not well understood. This paper provides a theoretical background for testing cross-firm differences in tax avoidance. We develop a formal model to analyze the incentives for firms to engage in tax avoidance. The tax avoidance decision is a function of moral hazard, tax planning costs, and pre-tax profit margins. If pre-tax profit margins are low, moral hazard problems drive the tax planning decision. In contrast, in case of high pre-tax profit margins, the tax planning decision is mainly driven by tax planning costs such as reputational costs. One implication of our model is that moral hazard can (partly) explain why some firms do not engage in tax avoidance. If moral hazard problems are severe, tax avoidance is less likely. Our model can be applied to test differences in tax avoidance across firms.

Research

Working Papers 2014/2015

Does Legality Matter? The Case of Tax Avoidance and Evasion, 2015 (with Kay Blaufus, Matthias Braune, and Jochen Hundsdoerfer).

ABSTRACT: Previous research argues that law expresses social values and could, therefore, influence individual behavior independently of enforcement and penalization. Using three laboratory experiments on tax avoidance and evasion, we study how legality affects individuals' decisions. We find that, without any risk of negative financial consequences, the qualification of tax minimization as illegal versus legal reduces tax minimization considerably. Legislators can thus, in principle, affect subjects' decisions by defining the borderline between legality and illegality. However, once we introduce potential negative financial consequences, legality does not affect tax minimization. Only if we use moral priming to increase subjects' moral cost do we again find a legality effect on tax minimization. Overall, this demonstrates the limitations of the expressive function of law. Legality appears to be an important determinant of behavior only if we consider activities with no or low risk of negative financial consequences or if subjects are morally primed.

Tax Policy and Corporate Investments Around the World (with Maximilian A. Müller)

ABSTRACT: This paper provides evidence on the effect of eight distinct tax policy tools on corporate investment using a large panel of listed firms from 68 countries and numerous policy shocks. Our paper confirms prior evidence on corporate tax rates and complements prior literature by providing evidence on the importance of payout taxes, labor income taxes, progressivity, and value added taxes for corporate investments. While higher corporate tax rates, progressivity of the corporate tax schedule as well as higher payout taxes and value added taxes decrease investments, higher labor income taxation spurs capital investments. Loss carryback provisions and group taxation regimes only increase investments of financially constrained firms. Overall, our elasticity estimates suggest that tax policy with low taxes on corporate profits and payout and high taxes on consumption can increase corporate investment.

Research

Other Research Activities 2014/2015

1st Berlin-Vallendar Conference on Tax Research

From July 8 to 10, 2015, the 1st Berlin-Vallendar Conference on Tax Research took place at Freie Universität Berlin. The conference was a special issue conference for the European Accounting Review and was highly selective. Less than 25% of submitted papers were accepted for the conference. Nine researchers had the chance to present their current projects on a broad range of international tax research. All papers were discussed by invited scholars, e.g., from the USA or the U.K.

To name a few examples of presented papers, Stacy Laplante (University of Wisconsin) presented her paper entitled “Trapped Cash: Estimating the Likelihood that a US Multi-national Firm has Cash Trapped in Foreign Subsidiaries” co-authored with Wayne Nesbitt from Michigan State University.

Rainer Niemann from University of Graz presented his joint work with Caren Sureth, University of Paderborn, on “Investment Effects of Taxes on Capital under Uncertainty and Irreversibility”. Their joint work was discussed by Richard Sansing from Tuck School of Business at Dartmouth, USA.

Jost Heckemeyer from Leibniz University of Hannover presented his joint paper with Sören Bergner (from University of Mannheim) on “Simplified Tax Accounting and the Choice of Legal Form”. The paper was discussed by Anna Feller from Ludwig-Maximilians-Universität München.

“Overall, we are very satisfied with the 1st Berlin-Vallendar Conference on Tax Research. We are proud that we were able to attract many international researchers and very interesting papers on the role of taxation in business decisions.” says co-organizer and guest editor of the European Accounting Review special issue Martin Jacob from WHU – Otto Beisheim School of Management.

The 1st Berlin-Vallendar Conference on Tax Research conference was organized jointly by Frank Hechtner, Freie Universität Berlin, and Martin Jacob, WHU – Otto Beisheim School of Management, Vallendar and was partly sponsored by Price Waterhouse Coopers. The next Tax Conference will take place in summer 2016.

Research

Impressions from the Conference



Research

Editorial Activity

- Guest Editor, Special Issue on Tax Research, *European Accounting Review*
- Editorial Board, *Business Research*

Reviewer Activities

- Standing Scientific Committee Member of the *European Accounting Association*
- Editor Special Issue on Tax Research *European Accounting Review*
- Incoming Associate Editor *European Accounting Review*
- Incoming Associate Editor *Accounting and Business Research*
- Editorial Board Member *Business Research*

WHU FAcct Center Research Seminar Series 2014/15

Ana Simpson, London School of Economics:
"Investor attention to salient features of analyst forecasts"

The study examines whether investors' response to salient features of analyst forecasts is influenced by lower information content of salient features, repetition of salient features and investor type. The authors use rounding of analyst forecasts as a salient feature because it represents a cognitive reference point, it is of limited information content and it lends itself to repetition.



Jost Heckemeyer, University of Mannheim:
"Simplified Tax Accounting and the Choice of Legal Form"

The study examines whether the availability of simplified tax accounting affects a firm's choice of legal form. The relief from standard accrual accounting is restricted to small, non-corporate businesses in order to protect them from high compliance burdens. Consistent with their expectations, they find that an increase in the eligibility threshold by € 100.000 reduces the corporate share by 0.41 percentage points. This is comparable to a cut of the top personal income tax rate which is applicable to non-corporate entities by 1.6 percentage points.



Joachim Gassen, Humboldt University of Berlin:
"Who Benefits from Voluntary Public Disclosure? Evidence from Italian Market Microstructure Data"

Using proprietary market microstructure data of Milan Stock Exchange, this paper examines the impact of public news arrival on sell-side and buy-side trading behavior. They use strategic plan presentations as voluntary disclosure events and cluster investors by their respective trading size. Their results point out that trading activity increases around news arrival regardless of investor type.



Florian Eugster, Stockholm School of Economics:
"Voluntary Disclosure Quality, Operating Performance, and Stock Market Valuations"

The study documents that higher voluntary disclosure quality leads to better operating performance and higher firm valuation. This confirms the hypothesis that managers have an ex ante incentive to communicate privately known positive information about future performance using extensive disclosure. The authors show that stock prices do not fully incorporate the value of higher disclosure quality allowing for future excess returns.



Arthur Kraft, City University of London:
"Real Effects of Frequent Financial Reporting"

The authors examine the effects of increased reporting frequency on firms' investment decisions using a sample of US firms over the period 1950-1970. Difference-in-difference estimates document that increased reporting frequencies lead to substantial declines in investment levels. Additional tests show that this decline is most consistent with myopic management behavior following increased reporting requirements.



WHU FAcct Center Research Seminar Series 2014/15

Scott Liao, University of Toronto:

“Financial Market Developments and Management Compensation”

In this study, they examine whether the deregulation of the US banking industry affects firms' pay-risk sensitivities in executive compensation. In particular, they study the branching provisions in the Interstate Banking and Branching Efficiency Act (IBBEA) that became effective in 1994. Their results show that the decrease in the relation between interest rates on bank loans and pay-risk sensitivities after IBBEA is higher for borrowing firms located in states with lower regulatory branch entry barriers.



Ahmed Tahoun, London Business School:

“The Power of the Street: Evidence from Egypt’s Arab Spring”

In this study, they analyze the Egypt’s Arab Spring. They show that these protests are associated with differential stock market returns for firms connected to the three groups. Using daily variation in the number of protesters, they document that more intense protests in Tahrir Square are associated with lower stock market valuations for firms connected to the group currently in power relative to non-connected firms, but have no impact on the relative valuations of firms connected to other powerful groups.



Arnt Verriest, EDHEC Business School Lille:

“Financial Reporting Quality and Peer Group Composition”

In this study, the authors analyze the composition of peer groups which are used to benchmark the compensation package of the CEO or the performance of the firm as part of a relative performance evaluation. Since accurate accounting numbers of potential peers are an implicit assumption in these benchmarking exercises, the authors investigate whether firms consider the financial reporting quality of potential peers when composing compensation and performance peer groups.



Gilles Hilary, INSEAD:

"Trust and Contracting"

In their study, the authors investigate the positive effect of trust on the economic welfare of nations, by analyzing the effect of exogenous trust on agency problems within organizations. They find that firms located in U.S. counties where trust is more prevalent use fewer and less detailed contracts. Compensation schemes have lower power, and direct monitoring is reduced as evidenced by the presence of fewer long term dedicated investors.



Vicky Kiosse, University of Exeter:

"Why do firms retain their defined benefit plans? Evidence form the UK"

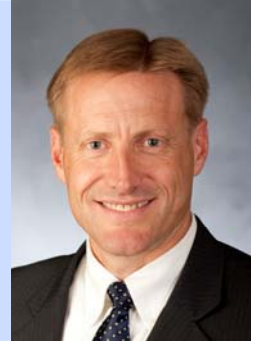
In their study, the authors investigate factors influencing the retention of defined benefit plans in the UK thereby examining the role of labor market incentives, managerial incentives and accounting standard changes. They find that firms for which human capital is of particular importance are more likely to retain their defined benefit plans as well as firms whose CEO or CFO is a member of the same pension plan that is provided to the other employees.



WHU FAcct Center Research Seminar Series 2014/15

Ted Christensen, Brigham Young University:
"Non-GAAP Reporting following Debt Covenant Violations"

In their study, the authors investigate the influence of creditor and investor scrutiny on firms' voluntary disclosure of non-GAAP earnings. They find that the likelihood of non-GAAP reporting declines sharply after a debt covenant violation. However, managers report the non-GAAP figure less aggressively if they elect to provide a non-GAAP earnings disclosure following a covenant violation. Finally, the authors show that market participants react differently to non-GAAP earnings following creditor intervention.



Ulf Brüggemann, Humboldt University of Berlin:
"The Twilight Zone: OTC Regulatory Regimes and Market Quality"

In their study, the authors analyze a comprehensive sample of more than 10,000 U.S. stocks in the OTC market, as little is known about this market. They investigate how market liquidity, price efficiency and crash risk, all of which capture aspects of market quality, differ across OTC venues and firms subject to different regulatory regimes, including federal securities and state blue sky laws. Overall, their results suggest that investors consider information and regulatory differences when trading OTC stocks.



Services for the WHU Community

- Chairman of the Search Committee “Assistant Professorship in Financial Accounting”
- Member of the Search Committee “Professorship in Financial Accounting”
- Organization of the “FAcCT Center Research Seminar Series”
- Weekly Organization of FAcCT Center Brown Bag Seminar
- Coordination of Teaching in Accounting & Taxation
- Deputy Group Speaker “Finance and Accounting Group”

Community Outreach & Sustainability

The sustainability of a tax system is one of the key issues of policy makers as not only short-term consequences but also long-term effects are relevant for the evaluation of tax reforms. Sustainability in taxation is discussed in all lectures of the chair of Business Taxation. Last year, a research project had direct policy influence on Swedish tax law and in the current year, the outcome of a research project is widely cited in the Norwegian tax policy debate.

The joint project “*Income Shifting in Sweden*” with Annette Alstadsæter, University of Oslo on income shifting and tax avoidance of closely held corporations has received great attention by the Swedish press and, ultimately, the Swedish parliament. In addition, one of the papers from this project (“Do Dividend Taxes Affect Corporate Investment?”) is widely cited in the Norwegian policy debate on future tax reform proposals.

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