



November 10, 2017

Mr. Russell G. Golden Chair
Financial Accounting Standards Board
401 Merritt 7
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Dear Chair Golden:

We appreciate the opportunity to share with you some of our views regarding the Accounting Standards Update (ASU), *Income Taxes (Topic 740): Disclosure Framework—Changes to the Disclosure Requirements for Income Taxes*.

We understand that the proposed ASU was issued as part of a broader disclosure framework to improve and expand footnote disclosures as one important form of communication in financial statements. Not surprisingly, enhancing disclosure requirements surrounding income taxes was selected by you as one of four important areas of focus. There is currently enormous public and political pressure for action to address perceived aggressive tax practices by multinational corporations (MNCs) globally. This represents not only an interest from governments and the public generally, but also from investors who need to understand the risks that MNCs are assuming from their conduct of profit shifting. MNCs can face billions in additional tax, interest, and penalties.¹

One fundamental way to address harmful tax practices is to improve transparency. This means that the FASB is in a unique position to act towards this effort in its proposed disclosure framework for income taxes. The FASB “develops and issues financial accounting standards through a transparent and inclusive process intended to promote financial reporting that provides useful information to investors and others who use financial reports”.² Given the current level of interest by most users of financial statements in the tax practices of large MNCs, we encourage you to include information contained in country-by-country (CbC) reports in the proposed framework as a required disclosure.³ In general, the demand for data from MNCs by country is pervasive across many stakeholders, industries, and interest groups.

To date, one response to addressing aggressive tax practices has been to put more information in the hands of taxing authorities worldwide.⁴ For instance, the OECD notes that “a

¹ See Kadet et al. (2016) See also Form 10-K for Microsoft (fiscal year ending June 30, 2015) and Form 8-K dated September 18, 2015, for the Coca-Cola Co.

² <http://www.fasb.org/jsp/FASB/Page/SectionPage&cid=1176154526495>

³ CbC reports provide information such as revenues, income, taxes, and employees by taxing jurisdiction. For U.S. companies, the information will be reported to the IRS on Form 8975 of the U.S. corporate tax return.

⁴ OECD (2015), Explanatory Statement, OECD/G20 Base Erosion and Profit Shifting Project, OECD. www.oecd.org/tax/beps-explanatory-statement-2015.pdf

lack of transparency can lead to [aggressive tax practices], if jurisdictions have no knowledge or information on the tax treatment of a taxpayer in a specific country and that tax treatment affects the transactions or arrangements undertaken with a related taxpayer resident in their country”.⁵ This prompted the implementation of, among other things, CbC reports, private disclosure between large MNCs and taxing authorities (and eventually shared among taxing authorities) meant to improve compliance, enforcement, and resource utilization.

Another, albeit more limited, response to addressing aggressive tax practices has been to put more tax information in the hands of the public.⁶ Instances of this response are more limited because there are two strongly opposing views on the costs and benefits of public disclosure of tax information. Proponents argue that increasing transparency of tax systems will encourage companies to pay their “fair share” of tax, improve accountability, and educate the public about compliance with tax laws. Opponents argue that the disclosures will create compliance burdens, divulge sensitive information, generate confusion, and lead to reputational damage.

It is important to note that putting more information in the hands of the public can take two key forms. It can involve the taxing authority sharing tax information with the public. That is unlikely to happen in the U.S. because CbC reports are part of the U.S. tax return and subject to stringent confidentiality requirements under Section 6103 of the U.S. tax code. The other way is to draft separate rules for public disclosure that may modify the content or scope of information disclosed. For instance, the European Parliament has approved the public disclosure of CbC reports, but has drafted ‘public’ CbC reporting requirements that are not completely aligned with the CbC reporting requirements to taxing authorities.⁷

The distinction regarding how tax information is disseminated to the public has two important implications for the costs and benefits of doing so. First, when issued directly by the taxing authority in whole or in part, the public receives information designed for tax enforcement. This information may not be easily understood by, or useful to, users of financial statements. For instance, when only a subset of information is released from a tax return, without the full set of information available to a taxing authority, there is the potential to generate confusion. Second, when a separate set of rules is drafted, there is the possibility of making the information that gets disclosed more useful to financial statement users. However, this also generates additional compliance costs (i.e., costs are zero when data is released publicly by a taxing authority).

We believe putting CbC information in the hands of the public vis-à-vis financial statements with little to no modification will provide useful information to firm stakeholders at

⁵ <https://www.oecd.org/tax/beps/beps-action-5-harmful-tax-practices-peer-review-transparency-framework.pdf>

⁶ Public release by taxing authorities of limited tax return data for large corporate taxpayers in both Denmark (2012) and Australia (2015) annually. Also, corporate tax return data is available in Finland, Norway, and Sweden.

⁷ The matter of broad-based public CbC reporting requirements for all EU-based MNCs remains unresolved. EU directives on extractive and financial firms apply to all EU member-states. For extractive firms, large companies must report all payments to governments on a country-by-country basis, but not revenues, profits, employees, assets, so it is a partial form of CbC. https://ec.europa.eu/info/business-economy-euro/company-reporting-and-auditing/company-reporting/public-country-reporting_en. For financial firms, EU banks must report CbC information close to the OECD requirements. This also applies to EU subsidiaries of foreign banks. <https://www.oxfam.org/en/pressroom/pressreleases/2017-03-27/europes-biggest-banks-register-eu25-billion-profit-tax-havens>.

a relatively low cost both to firms and their stakeholders. We elaborate below.

1. Making information in CbC reports public will benefit investors

Investors need information to assess the amount, timing, and uncertainty of the future cash flows of a firm to make investment decisions. As governments lay claim to a significant portion of firms' income, investors demand tax information. The amount of taxes that an organization expects to pay on its income is thus an important data point, and not surprisingly there are numerous disclosure requirements already in place under FAS 109 regarding tax obligations at the firm-level. When firms are engaging in aggressive tax practices that may not be sustainable, investors also need information about risk. The FASB addressed this need with the implementation of FIN 48 in 2006, which provides information to investors about the maximum amount of additional tax to be paid in the future for uncertain tax positions, again at the firm-level.

CbC reports, which provide financial information on an individual country basis, would provide investors with useful information to more accurately assess future cash flows and risk. Although the information was designed for tax enforcement, it would be useful to investors with little or no change in the nature or scope of information disclosed.

The idea behind CbC reports is that it will facilitate high-level tax risk assessment by taxing authorities. It follows then, that it would be useful to an investor in performing high-level risk assessment. Both stakeholders – investors and governments – are looking for the potential existence of unsustainable tax strategies. At a minimum, the information would provide a basis for enhanced discussions among investors, managers, and boards of directors.

Moreover, CbC reports resemble segment reporting disclosures, which have been required in financial statements for decades. The very premise behind segment reporting is that an entity's risks and returns are affected predominantly by the product or services it produces or by the fact that it operates in different geographical areas. If this is well-accepted in the context of assessing the amount, timing, and uncertainty of a firm's pre-tax cash flows, it is not a leap to recognize that the risks and returns of tax reporting are affected predominantly by the taxing jurisdictions in which a firm maintains group members, conducts operations, earns revenues from local customers, reports income, and pays taxes. Accordingly, having information by country would enable investors to better assess the risks associated with tax-related cash flows.

Currently, the FASB exposure draft requires entities to disclose pre-tax income, tax expense and taxes paid disaggregated between domestic and foreign earnings, as well as further disaggregation of foreign taxes paid to significant countries.⁸ Requiring disclosure of similar information from CbC templates would go one step further by providing information for *all* countries. If the information is already being produced by country for tax purposes, it is not clear why more aggregated data would be issued publicly. There is no incremental compliance burden on the company to disclose information for all countries, and this removes the possibility that the definition of 'significant' would not adequately capture the taxing jurisdiction(s) generating tax risk for the firm. Further, it seems apparent that some MNCs report revenues within countries in which they conduct no significant operations, thereby side-

⁸ http://www.fasb.org/jsp/FASB/FASBContent_C/ProjectUpdatePage&cid=1176164227426

stepping any meaningful segment reporting.

2. Making information in CbC reports public will benefit other users of financial statements

The traditional users of financial statements are shareholders, creditors and analysts. As described above, these users would benefit from having CbC information when assessing future cash flow and risk associated with tax reporting decisions made by firm managers. However, firms have many other important stakeholders including consumers, employees, and government officials. The FASB “develops and issues financial accounting standards through a transparent and inclusive process intended to promote financial reporting that provides useful information *to investors and others who use financial reports*”.⁹

These other users of financial statements are becoming increasingly adept at interpreting a set of financial statements, particularly with respect to taxes. Their focus is more around a company’s contribution to the economy and society in general as well as whether the behavior of the company conforms to ideals of what is acceptable within that society. Since corporate taxes are raised at the country-level rather than the entity-level, consolidated financial statements are not very useful in this context. Therefore, each of these other firm stakeholders would benefit from CbC reporting as well because the data are reported by country and therefore, present disaggregated financial information pre-consolidation.

3. Making information in CbC reports public will not generate significant costs

a. Compliance costs

The compliance costs associated with requiring financial statement disclosure of information from CbC reports would be negligible. The information is already being produced to comply with tax rules and regulations, so unless significantly different CbC reporting requirements were drafted for public disclosure there would very little additional compliance costs.

There would be some additional compliance costs from the need to audit the CbC information. As the information is produced by firms for inclusion on a U.S. tax return, and is therefore not currently subject to audit or internal control regulations, there would be incremental internal and external audit costs, as well as additional technology costs. These additional compliance costs however are significantly reduced considering the global trend towards the production of country-level information for tax compliance and enforcement.

b. Proprietary costs

Typically, one thinks of a disclosure related cost as solely the compliance cost, or the cost of preparing and disseminating information. However, disclosure related costs also include the cost associated with disclosing information which may be proprietary in nature and therefore potentially damaging to the firm. When firms disclose information that may be useful to competitors, shareholders, regulators, customers, or employees in a way which is harmful to a firm’s prospects even if (or perhaps because) the information is favorable, the disclosure is said to

⁹ <http://www.fasb.org/jsp/FASB/Page/SectionPage&cid=1176154526495>

generate proprietary costs.¹⁰

In the context of disclosure of tax information, the proprietary cost argument is often invoked by those opposing disclosure on the basis that disclosure will weaken a firm's competitive position when negotiating with tax authorities. The proprietary cost argument was invoked repeatedly in the context of FIN 48, for example where firms were concerned that the information disclosed in the financial statements would be used by taxing authorities.¹¹ CbC reports are already being produced for and used by taxing authorities, and at some point, will be shared among taxing authorities. This is quite different than a situation where a disclosure is specifically designed to meet the needs of investors, and investors are then concerned that a taxing authority will use the information contained in the financial statements.

Another factor that makes CbC reports unique is the lack of proprietary costs regarding competitors. CbC reports include information about income and taxes paid, among other things, on a pre-consolidated basis. That is, intercompany transactions are not eliminated for the purposes of CbC reporting. This is what allows taxing authorities (and investors as we argued earlier) to perform high-level assessments of tax risk. The proprietary cost argument was invoked in the context of segment reporting but this setting is distinct from segment reporting because segment reports eliminate intercompany transactions while CbC reports do not. It is unclear to us what a competitor would learn from pre-consolidated country-level data that would harm a firm's competitive position. The existence of (cross-border) intercompany transactions in the MNC context means that reported country-level profits are a function of economic profits and any firm decisions regarding profit shifting. The proprietary cost argument applies to disclosure of economic profits, which would not be learned from CbC reports.

c. Reputational damage

Finally, one might argue that CbC reports will generate confusion among consumers or the public, resulting in reputational damage to the firm. We do not agree for two reasons. First, at least in the context of Australia, research finds no evidence of a change in consumer sentiment in Australia when the taxing authority released country-level income and tax payments of large public companies.¹² That is, brands of large MNCs appear quite resilient to public disclosure of information that is suggestive of aggressive tax practices. Second, in cases where the information could be misunderstood, firms always have the option of voluntary disclosure. In fact, we find that the propensity of Australian firms to adopt voluntary disclosure is greater when the tax information of the firm subject to disclosure is more complex (or confusing). Thus, we see no reason why firms could not pre-empt potential reputational damage with voluntary disclosure.¹³

¹⁰ Verrechia (1983) termed these costs 'proprietary costs'. Examples include a disclosure that might prompt a bank to recall a loan, a regulator to issue an enforcement action, a labor union to demand a concession, etc.

¹¹ See Robinson and Schmidt (2013) in the context of FIN 48 implemented by the FASB in 2006.

¹² See Hoopes, Robinson and Slemrod (2017).

¹³ Ehinger, Lee, Stomberg, and Towery (2017) document that 82 percent of quarterly earnings conference calls already mention income taxes.

Sincerely,

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