Did FIN 48 Arrest the Trend in Multistate Tax Avoidance?
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Discussion by
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Summary of Comments

- Distinction between avoidance, aggressiveness, and nexus confusion

- Trends in ETRs, collections, and voluntary disclosure agreements prior to FIN 48 enactment

- Empirical tests
Avoidance, Aggressiveness, Uncertainty

• Did FIN 48 Arrest the Trend in Multistate Tax Avoidance?
  – The word “avoidance” denotes intentional

  – Consistent with Mills et al. (2009), the authors “view tax aggressiveness as claiming a tax benefit with relatively weak facts to sustain the benefit if the company were audited… (e.g., tax evasion, some tax avoidance, and unintentional errors such as corporations being unaware of filing requirements).”

  – Not filing due to nexus uncertainty meets definition of “tax aggressiveness” but is it always “avoidance”? 
Nexus & Non-filing

• Decision not to file in a jurisdiction is a “tax position” under FIN 48 (paragraph 4)

• Statute of limitations

• National Nexus Program (NNP)
  – 41 states participate
  – 270 days, on average, between case opening and effective date of decision
  – Number of agreements peaked in 2003 and 2004, coinciding with the peak of amnesty agreements in 2002 and 2003
  – Initiation of voluntary disclosure agreements for income tax peaked in 2006, then declined
“Arrest” or “Contribute to Decline”

• Peak of amnesty agreements and voluntary disclosure agreements 2002-2004

• Exposure draft released in July 2005. According to Frischmann et al. (2008), there wasn’t much press coverage of FIN 48 before that date.

• Announcement date that “not filing” is a position that has to be evaluated under FIN 48?
Figure 4.
Trend of Voluntary Disclosure Agreements Between Income Taxes and Sales and Use Taxes
Count of Voluntary Disclosure Agreements (Based on Offer Date)

Source: Multistate Tax Commission from National Nexus Program.
FIGURE 1
Mean State and Federal Effective Tax Rates (1995–2007) (a)

Mean State and Federal Effective Tax Rates, 1995-2007

(a) Source: Compustat
Modeling State ETRs

• Number of states (Gupta & Mills 2002)

• Logic of interacting AdvIntensity with Trans

• Surprising that YearAfter1995 is insignificant in Domestic Firms column
FIN 48 Reserve Tests

• Main result: Coefficient is larger for state tax avoidance than for federal or foreign tax avoidance

• Comments:
  – Scalar
  – ForeignPct
  – Change in UTB at adoption
Main Analysis: 2-year Chg in StateETR

• Main result:
  – Firms that were most aggressive (i.e., lowest ETR) between 1995-2005 have largest increases in ETR in 2006 and in 2007

• Comments:
  – 2-year change
  – Number of states
  – YearDummy=2005
Main Analysis: 2-year Chg in taxes paid

• Main result:
  – Taxes paid increase in 2006 and in 2007 but no difference between most aggressive firms between 1995-2005 and all other firms

• Comments:
  – YearDummy=2005
  – Great that results are significant for 2008 in preliminary tests!
  – State corporate income tax collection results in Table 8 are promising
Conclusions

• Important question for financial statement users and state tax administrators
• “Arrest” might be too strong
• Distinguish between firms decreasing “avoidance” vs. firms being uncertain about nexus
• Incorporate change in number of states (as explanatory variable and possible dependent variable)
• I look forward to seeing the 2008 results!