Academic research for your practice consideration

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One year ago, this column featured four published examples of academic research of interest and relevance to tax practitioners (Meade, "Campus to Clients: Practitioners Can Benefit From Academic Tax Research," 51 *The Tax Adviser* 532 (August 2020)). This year another four published articles by tax academics are highlighted. The process by which these articles were selected is the same as last year: Articles were nominated and evaluated by members of the American Taxation Association's (ATA's) External Relations Committee, which sought to identify academic tax research that was timely and relevant to tax practitioners. The ATA is the leading organization of tax academics, and its External Relations Committee strives to bridge the gap between tax academics and tax practitioners.

Academic tax research, like other types of academic research, begins with a question. In many instances this question is prompted by conversations with, or the writings of, tax practitioners. The question is then translated into a testable hypothesis, and this is framed within the context of prior studies and related literature. Data is then collected, and rigorous statistical analyses are performed. Alternatively, academic research can delve into a technical analysis or critique of a tax provision or policy matter, as one of the articles highlighted this year illustrates.

Researchers typically present their findings to peers. Based on feedback received during these presentations, researchers may modify their study or expand the analyses with the aim of submitting their work to a high-quality academic journal.

The journal review process imposes additional demands on the research. As detailed in the earlier column, academic manuscripts are generally critiqued by a journal editor and two reviewers knowledgeable in the area. Manuscripts often undergo numerous revisions, and acceptance rates at top journals are low. For the journals represented in this column, acceptance rates average between 10% and 20%.

'An Experimental Investigation of Tax Professionals' Contentious Interactions With Clients'

In this article about certain difficult client interactions, published in the Fall 2019 issue of *The Journal of the American Taxation Association* (Vol. 41, Issue 2), authors Donna Bobek, Derek Dalton, Amy Hageman, and Robin Radtke examined how tax professionals persuade clients to abandon overly aggressive tax positions while still acting as advocates for the client. The authors also explored ways public accounting firms can help tax professionals successfully handle contentious interactions with clients.

The authors employed an experimental questionnaire to gather descriptive data from 89 tax professionals about their personal interactions with clients. Among the persuasive arguments used, 75% of the surveyed tax professionals informed the client that there is no substantial authority for the client's position, and 74% warned the client of potential penalties. Other frequently used arguments include telling the client that there is not a reasonable basis for the position (61%), the audit risk is high (49%), and an audit by the taxing authority may uncover other items (47%). The most common types of contentious tax issues faced by the respondents involved deductions (18%), business versus personal (15%), S corporations (12%), revenue recognition (11%), and foreign or state questions (10%).

Regarding issue outcomes, 73% of respondents indicated that they were able to reach an agreement with the client. However, only 44% of the respondents stated that the agreed-upon outcome was the position originally recommended by the tax professional; 13% reached an agreement somewhere between the original positions of the tax professional and client; 11% agreed on a new solution; and 5% agreed on the client's original position. Approximately 15% of the respondents indicated that they were not able to reach an agreement with the client and that this ended the client-professional relationship. Another 2% indicated that the issue was dropped; 1% indicated that it was still contentious; and 9% indicated a variety of other outcomes, some involving IRS action.

After analyzing the results from the experimental questionnaire, the authors developed a follow-up survey that classified contentious issues into two categories: clear-cut and ambiguous. Clear-cut issues were those involving situations in which the client was unambiguously wrong, and the tax professional was required to persuade the client not to pursue the position. Ambiguous issues were those in which the appropriate resolution of the issue was less certain, and the client was reluctant to follow the tax professional's advice. The follow-up survey was completed by 140 CPAs in tax practice.

Results from the follow-up survey indicated that respondents believed 12% of engagements involved a clear-cut contentious issue and 14% involved an ambiguous one. The most frequent reason for trying to persuade the client on a clear-cut issue was to protect the tax preparer (over 77%), while respondents indicated that on an ambiguous issue, they mostly wanted to protect the client (almost 85%).

Regarding firm training, only 8% of respondents indicated that their firms provide formal training on how to handle client negotiations. Over 75%, however, thought their firms should provide training in interpersonal skills, and more than 55% favored training in general or tax negotiation strategies.

'Regulation and Tax Preparer Qualifications'

Tax preparer regulation is a controversial issue. Proponents assert that regulating tax preparers improves tax return quality by screening out incompetent and unscrupulous tax preparers. Opponents argue that regulation diminishes the incentive for preparers to attain high-level credentials, resulting in lower overall tax return quality. They also claim that regulation increases costs by restricting the supply of preparers.

Using a unique dataset of all U.S. tax preparers who registered for a preparer tax identification number (PTIN) with the IRS between 2012 and 2016, authors Matthew Reindenbach, Trevor Sorensen, and John Treu examined the effect of regulation on tax preparer qualifications. Their article, published in the Spring 2021 issue of *The Journal of the American Taxation Association* (Vol. 43, Issue 1), investigated the effect of state regulation in Oregon and California, which dates to the 1970s, as well as the impact of the Service's Registered Tax Return Preparer (RTRP) program, which was in effect during 2012. The authors focused on tax preparer qualifications because tax return information is not publicly available. However, their dataset, which was obtained directly from the IRS through multiple Freedom of Information Act requests, contains preparer professional qualifications, and these are often viewed as indicators of quality.

The authors first tested whether state regulation in Oregon and California is associated with a higher proportion of highly qualified tax preparers (HTPs) who are credentialed as CPAs, attorneys, or enrolled agents in those states relative to nonregulated states. Given that Oregon has more stringent requirements than California, the authors expected Oregon would have more HTPs than California. The statistical analysis used by the authors to test the effect of state regulation on HTPs controlled for the likelihood of becoming an HTP in each state based on average state education level, the supply of attorneys, and the annual pass rates on legal and accounting certification exams. The analysis also controlled for a state's accounting firm employment opportunities and the proportion of total tax preparers located in a state's metropolitan statistical areas. In addition, the analysis included controls for state population, per capita income, unemployment, and the proportion of non-English speakers. The authors' second set of statistical tests focused on whether the implementation and removal of the Service's RTRP program affected individual tax preparer decisions to obtain a credential or to let one expire.

Results for their test of state regulation showed that a significantly higher proportion of HTPs practice in Oregon and California relative to nonregulated states. The authors interpreted this finding to suggest that tax preparers in a given market are more likely to hold an HTP certificate if regulations are imposed over an extended period. The authors also found that enrolled agents are more sensitive to tax preparer regulation than attorneys or CPAs. But contrary to expectations, the authors found no difference in the proportion of HTPs in Oregon as compared with California.

Results for the effect of the Service's RTRP program on preparer qualifications showed that after the elimination of the RTRP program, new tax preparers were less likely to be HTPs; this finding is consistent across all states. New preparers in Oregon and California, however, were more likely to have an HTP credential following the lapse of the RTRP program relative to new preparers in nonregulated states. In supplemental tests, the authors also found evidence that tax preparation fees in Oregon and California were about 26% and 3% higher, respectively, than in nonregulated states. Finally, they found that Oregon had significantly lower tax deficiencies when compared with a similar nonregulated state, but that California's tax deficiencies were similar to those of a matched nonregulated state.

'The Effect of Tax Avoidance Crackdown on Corporate Innovation'

One of the most frequent techniques for reducing corporate tax is to shift income from high-tax to low-tax jurisdictions using intangibles. In response to this tactic, many U.S. state governments have adopted addback statutes that specifically target tax-motivated income-shifting transactions using intangibles. These statutes require firms within the adopting state to add back to their state taxable income intangible-related expenses paid to related parties in other states. In this article, published in the April-May 2021 issue of the *Journal of Accounting and Economics* (Vol. 71, Issues 2-3), authors Qin Li, Mark Ma, and Terry Shevlin addressed a possible negative consequence of addback statutes. Specifically, they examined whether the adoption of addback statutes by U.S. state governments impedes corporate innovation and, if so, whether the magnitude is economically important.

Using data from company financial reports, subsidiary disclosures, patent counts, and citations, as well as data on state statutory tax rates and R&D tax credits, the authors statistically tested for the effect of addback statutes on future innovation. The authors measured innovation using both patent counts and citation counts. Patent counts are the number of patents filed by a firm in a given year, while citation counts are the number of non-self-citations received by a firm's patents in a year. To mitigate the confounding effects of firm characteristics and other tax policies across states, the authors included a number of firm-specific and state-specific control variables.

Results from the authors' primary test indicated that operating in a state that has adopted an addback statute is negatively associated with the number of patents filed three years later. The authors selected the three-year forward period based on prior studies that assumed the innovation process lasts three years. The authors estimated that after the adoption of an addback statute in a state, the number of patents filed by affected firms three years later decreased by 4.77 percentage points, which is equivalent to approximately 0.639 patents. In a related test, the authors also found that after the adoption of an addback statute in a state, firms with material subsidiaries in that state had a reduction of approximately 5.12 percentage points in the number of citations on patents filed three years later.

In subsequent tests the authors addressed whether the decline in patents is related to firms using low-quality patents for tax-motivated income shifting. The authors concluded that addback statutes negatively affect both high- and low-quality patents. They also found evidence that the adoption of addback statutes does not affect the location of patents either in the United States or overseas. To alleviate concerns about confounding effects of other tax policy changes and state economic conditions, the authors reran their primary test after controlling for state-level economic conditions. They also addressed concerns about measurement errors by running a number of robustness checks. The authors concluded that addback statutes impede corporate innovation.

'Feeling GILTI: Tax Strategies for U.S. Multinational Corporations to Navigate the Tax Cuts and Jobs Act'

The law known as the Tax Cuts and Jobs Act (TCJA), P.L. 115-97, signaled a shift in U.S. tax policy away from a worldwide tax regime and toward a partial territorial system. Prior to the TCJA, the United States had taxed some income earned by foreign subsidiaries of U.S. parents under Subpart F and had deferred the remaining income until repatriated. The

TCJA eliminated this deferral by introducing a 100% dividends-received deduction. But the act also limited potential income shifting by adding global intangible low-taxed income (GILTI) as a supplement to Subpart F. The GILTI rules, along with the base-erosion and anti-abuse tax (BEAT) and the foreign-derived intangible income (FDII) provisions, added considerable complexity to an already cumbersome area of tax law. In this article, which is scheduled to be published in the Fall 2021 issue of *The ATA Journal of Legal Tax Research*, authors Brett Bueltel and Andrew Duxbury reviewed the history of U.S. international tax policy and analyzed the technical aspects of GILTI. They also proposed four strategies to minimize the tax consequences of GILTI. They concluded with an evaluation of whether GILTI achieves its intended purpose and whether it represents good tax policy.

Enacted in 1962, Subpart F subjects certain types of income earned by controlled foreign corporations (CFCs) to current U.S. tax. In conjunction with the transfer-pricing rules and foreign tax credit limitations, Subpart F serves to protect the U.S. tax base by limiting firms' ability to shift income. One major shortcoming of Subpart F, however, is cost-sharing arrangements. Under these arrangements, a U.S. parent and CFC contractually share the cost of developing a product or technology, with the CFC generally reporting some or all of the non-U.S. profits related to the new intangible outside the United States.

To mitigate income shifting and address some of Subpart F's shortcomings, the TCJA introduced three new provisions: BEAT, FDII, and GILTI. The GILTI provisions created a new classification of foreign income that is immediately subject to U.S. tax. The calculation of GILTI is complex, but it is generally equal to the amount of a CFC's total income in excess of its net deemed tangible income return. A CFC's net deemed tangible income return equals 10% of the entity's investment in tangible depreciable assets less interest expense. The calculation effectively creates an exemption from U.S. tax for a 10% return on tangible investments in CFCs. The tax on GILTI is particularly significant for CFCs whose profits are high in relation to their investment in tangible assets, such as CFCs providing services, logistics, procurement, distribution, and technology.

Bueltel and Duxbury proposed four strategies to mitigate the tax effects of GILTI. The first two involve operational changes, while the last two have limited business impact. Strategy 1 is good for firms wanting to take greater control of the manufacturing process or looking to expand operations. It involves the purchase of a foreign third-party manufacturer that has substantial depreciable assets. Strategy 2 involves replacing older depreciable assets in CFCs with new assets. Strategy 3 centers on entering into capital leases that are recorded as depreciable assets. Strategy 4 involves combining unprofitable CFCs with profitable CFCs. The authors caution that each strategy has its limitations and must be considered in association with other tax rules.

Bueltel and Duxbury concluded by addressing the policy implications of GILTI. They argued that although GILTI achieves its purpose of discouraging U.S. multinationals from shifting future income overseas, it fails three key principles of good tax policy. Specifically, they observed that GILTI is not horizontally equitable because U.S. multinationals with the same income may be taxed differently depending on their industry and the age of their assets. GILTI also is not tax-neutral because it puts U.S. multinationals at a disadvantage with respect to foreign competitors when acquiring or expanding into foreign jurisdictions. Last, they pointed out that GILTI is not simple because it, together with the companion BEAT and FDII provisions, requires firms to engage in difficult and costly tax compliance planning.

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