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The Three Hurdles of Tax Planning: How Business Context, Aims of Tax Planning, and Tax Manager Power Affect Tax Expense*

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WORKING PAPER

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Abstract

The question of why some companies pay more taxes than others is a widely investigated topic of interest. One of the famous suspect explanations is a phenomenon called tax avoidance. We develop a holistic theoretical concept of influences on corporate tax planning through a series of 19 in-depth German tax expert interviews. Our findings show that three distinct hurdles in the tax planning process can explain different levels of tax expense across companies. Those three hurdles are which tax planning methods are. available (defined by business context), desirable (given via aims of tax planning), and implementable (determined by tax manager power). A large part of previous research has estimated the influence of firm characteristics, which we define as part of the business context, on the tax expense, while the other influences that we identify have largely been left "out of the equation". In order to apply and operationalize the identified three-hurdle concept, we construct five short, real-world company case studies. In these case studies, we show how variation in two key constructs across companies leads to different levels of tax expense. First, companies vary widely in the aggressiveness of their aims of tax planning. Second, tax managers can assume very different levels of power in their organization, determining the ability to implement tax planning methods. In conclusion, we provide generalizable insights into the tax planning process of companies which help to explain the observed variation in tax expenses across firms.

Keywords: tax planning, tax avoidance, manager power, qualitative research

JEL Classification: D22, H25, M12, M41

1 Introduction

Why do some companies pay more taxes than others? Recently, the answer to that question has tended to be: corporate tax avoidance. This omnipresent phenomenon is a topic of interest to both policy makers and researchers alike. Not only the Organisation for Economic Co-operation and Development (OECD) has revived its previous interest in "harmful tax competition" (OECD, 1998) by launching a new project to analyze profit shifting behavior of multinational companies (OECD, 2013), but also has this interest been mirrored by an increase in investigative articles on multinationals' tax planning practices. Research on corporate tax avoidance has drastically outpaced research on taxation as well as scientific research in general, and increased more than six-fold in the past 10 years compared to the preceding decade.[1]

Early scientific inquiries into the determinants of differing corporate tax burdens did not feature tax avoidance as an explanation. Instead, researchers tried to link various firm characteristics to effective tax rates [ETRs] and continuously expanded the pool of factors driving the observed variation in those (e.g., Stickney and McGee, 1982; Gupta and Newberry, 1997; Janssen, 2005; Liu and Cao, 2007; Richardson and Lanis, 2007; Delgado et al., 2012). Since a large portion of the variation remained unexplained, tax avoidance was introduced as a possible explanation and, consequently, determinants of tax planning outcomes became "human". Accordingly, research studies increasingly focused on the impact of managers, auditors, and other stakeholders on tax expense, which supposedly reflects information about tax avoidance (e.g., Phillips, 2003; Dyreng et al., 2010; Brown, 2011; Graham et al., 2012; Lipatov, 2012). As an example of stakeholder influence, Dyreng et al. (2010) find that there is a significant effect of tax managers on corporate ETRs; however, this cannot be linked to specific characteristics of the executives (e.g., age, education).

Based on this research, there are a few puzzles to be solved and conflicting evidence to be reconciled. As a first example, the most common measure of tax avoidance is still a set of multiple annual ETR measures, despite the fact that research has analyzed the low predictability (i.e., the high degree of idiosyncrasy) of one year's ETRs for subsequent years' ETRs (Dyreng et al., 2008). Second, there are several incidences of (seemingly) contradicting evidence. One example is the variety of effects attributed to company size, profitability, and other firm characteristics ranging from positive to negative influence on tax avoidance or even exhibiting no influence at all.[2] Another example is the effect of reputational consequences of tax

[1] The respective numbers for scholarly articles published between 1994–2003 and 2004–13 are: 31 vs. 190; 29,341 vs. 48,237; 768,895 vs. 1,239,786.

[2] Just to exemplify this fact for one characteristic, the debate on the influence of size on a company's tax burden has

avoidance. In a recent survey, Graham et al. (2014) find that reputational considerations are the top two reasons why firms do not plan their tax accounts more aggressively. Contrary to this, Gallemore et al. (2014) find that negative reputational effects cannot be observed for firms identified as engaging in tax sheltering. Following these observations of current tax research, which consists of mostly quantitative empirical studies, we argue that what is missing in the current discussion on tax avoidance is a more in-depth understanding of how the actual tax planning occurs in a corporate context.[3] This includes answers to how companies make decisions with regard to paying taxes, and under which constraints and enablers tax managers operate.[4] Thus, we formulate our research questions:

1. Which internal and external factors account for differences in how companies perform tax planning?
2. How are those differences in the company's setup related to different levels of tax expense?

Given the state of current research, we derive that it is highly relevant and beneficial to investigate the aforementioned questions in a grounded theory approach, that is, through the "development of theory from [data generated] insights" (Glaser and Strauss, 1999, 254). Such a qualitative approach is especially promising because previous quantitative research was not yet able to either bring the contradicting evidence in a coherent framework or to provide compelling explanations for the motivation for tax avoidance and the special role of different stakeholders, such as of tax managers, in the process.

Our contribution is twofold: First, based on the expert interviews, we systematize the tax planning process along three distinct hurdles. This plausible three-hurdle concept helps us to locate more specifically sources of variation in tax expenses across companies:

- Specific tax planning methods may or may not be available within the business context (*hurdle 1*);
- Of the available methods not all are desirable as per the company's tax planning aims (*hurdle 2*);
- Finally, not all methods remaining after hurdle 2 are implementable in the organization, especially due to lack of tax manager power (*hurdle 3*).

resulted in advocates of both the "political cost" and the "political right" hypothesis, expecting companies to pay higher and respectively lower taxes with increasing size. Evidence for the first (e.g., Delgado et al., 2012; McGuire et al., 2012) and the second (e.g., Gupta and Newberry, 1997; Mills, 1998; Frank et al., 2009; Cheng et al., 2012) exist, with yet a couple of studies demonstrating no effect (e.g., Rego, 2003; Phillips, 2003; Armstrong et al., 2012). One has to note, however, that the proxies of company size differ between the studies (i.e., natural logarithm of assets, sales or market capitalization), as do proxies of tax avoidance (i.e., different ETR measures, book-tax-differences [BTD]).

[3] Apart from quantitative empirical studies, some examples of model-based/theoretical work include Devereux and Griffith (1998), Chen and Chu (2005), Crocker and Slemrod (2005), and Lipatov (2012), while experimental or qualitative research is still underrepresented (e.g., Wilson, 1993; Eberhartinger and Fellner, 2012).

[4] Put more abstractly, this view corresponds to the assessment that "critical analyses of tax as a social phenomenon [are] of considerable significance to scholars of accounting" (Boden et al., 2010, 543).

Second, within this three-hurdle concept, hurdle 3 is an entirely new influence on tax expense, that is, the power of tax managers to implement tax planning strategies. This tax manager power is a function of both the organizational power of the tax department and individual power of the Head of Taxes. By identifying tax manager power as a differentiator among companies, we enhance and adapt our knowledge from previous research about the remaining stand-alone influence of, for example, incentives and expertise on tax expense. In our real-world company case studies, we can therefore show that two companies which are similarly aggressive in their aims of tax planning yield very different tax expenses compared to their industry peers because of differences in tax manager power.

The remainder of this paper is organized as follows: Section 2 reviews the related literature on the tax planning process and organization, as well as research on determinants of different levels of tax expense and one of its possible causes, that is tax avoidance. Section 3 introduces the research methodology and the data used. In Section 4, we present our findings in the form of a three-hurdle concept of the tax planning process. Section 5 features the five company case studies to operationalize and prove the applicability of this theory. Section 6 summarizes and concludes.

2 Theoretical Background

Our research project draws on two major streams of literature. First, insights from research on organization aspects will help to understand existing knowledge on variants of the tax planning process and organization structure and, consequently, their influence on tax expense. Second, we take a closer look at the identified determinants of high or low tax expense, and other measures of tax planning outcomes, and we will then structure what current research reveals concerning the link between corporate tax avoidance behavior and those measures of tax planning outcomes (e.g., levels of tax expense).

Research on Tax Planning Processes and Organization Structure

Since we are interested in the factors influencing corporate tax planning, we draw on insights from previous research on the tax planning process, as well as on organization structure. To our knowledge, there are three relevant, mostly practice-oriented works. In a small-sample study by Wilson (1993), we learn that companies differ in how they integrate tax planning into their overall business planning, and that both tax (e.g., regulation) and non-tax factors (e.g., frictions related to coordinating value chain activities) can explain those differences. Defining the degree of integration of the tax function more broadly, a term coined "tax embeddedness" (Mulligan, 2008, 25) is introduced to assess the perception of the tax function in the company and the degree of integration of taxes in the overall strategy. Firms with higher tax embeddedness seem to have tax-interested CFOs, long-tenured Heads of Taxes, and tend to be more diverse. The implications for the tax expense of those firms are, however, not clearly assessed. Investigating not only the actual cooperation between the tax department and the business units, researchers also analyzed the ex-ante expectations towards the tax department (Douglas and Ellingsworth, 1996). Findings suggest that objectives for the tax department are mostly determined from within and that few other sources (e.g., benchmarking) are used to objectify the performance of the tax department.

Tax Avoidance Theory

We will now turn to what current research reveals concerning the determinants of different levels of tax expense and the link to corporate tax avoidance behavior. Interestingly, in the case of tax avoidance, the phenomenon was subsequently attributed to an existing measure—the ETR—rather than the other way round (identifying a phenomenon called tax avoidance and looking for an appropriate measure).[5] Emerging research on corporate tax-paying behavior originally took a different, more tax policy-focused view point than is the case today. Stickney and McGee (1982), Wilkie (1988), and Gupta and Newberry (1997) formulate their research questions to find out whether the tax system was neutral, that is, whether firm characteristics did not lead to different levels of corporate ETRs. These studies analyze and, to some extent, successfully link firm characteristics, such as leverage, industry affiliation, company size, and profitability, to such a measure of relative tax expense.[6] We still find many of those early variables as controls in current research on tax avoidance (Hanlon and Heitzman, 2010). Due to a remaining large portion of unexplained variation in ETRs, a link is thus hypothesized to exist between ETRs and tax avoidance behavior. Since tax avoidance behavior cannot easily be observed directly, scholars investigate the influence of indicative variables, such as the extent of foreign operations (Rego, 2003) and specific tax-saving schemes (Brown, 2011), on the level of tax expense.

Apart from these quantitative, descriptive firm characteristics, scholars started to explore three facets

[5] ETRs refer to the ration of a periodic tax liability (usually on an annual basis) to pre-tax income. Different types of ETRs can be distinguished, for example, the cash ETR, which is expressed by taxes payable divided by pre-tax income, or current ETR, which is calculated as current tax liability divided by pre-tax income.

[6] Leverage is mostly calculated as the ratio of long-term debt to total assets (in many small variations of, e.g., adding the current portion of long-term debt). Industry affiliation is often expressed as dummies in a fixed-effects model based on standard industry classifications (SIC). Company size is least homogenously proxied as the natural logarithm of (net) sales, total assets, or market capitalization. Profitability is often included both as a dummy variable of net operating losses and as the profitability margin of return on assets (ROA).

of the multi-stakeholder setting of corporate tax avoidance since, also in a corporate context, people ultimately make decisions. First, a series of research questions deals with characteristics of managers and their influence on various measures of tax avoidance (e.g., Desai and Dharmapala, 2006; Desai et al., 2007; Boone et al., 2013). As an example, Dyreng et al. (2010) find that there is a significant effect of tax managers on corporate ETRs; however, this cannot be linked to specific characteristics of the executives (such as age, education, etc.). An additional problem is that this causality could work vice versa considering self-selection in the matching of companies and managers. For example, more risk-averse, religious managers (see Boone et al., 2013) could choose low risk, low tax avoidance firms. Second, the "separation between ownership and control in public corporations" (Slemrod, 2004, 883) calls for an adaptation of the standard model to take into account such a principal-agent-setting, and scholars also assess incentives for managers to avoid taxes. Findings suggest that equity incentives have a positive influence on common measures of tax avoidance (e.g., Desai and Dharmapala, 2006; Lanis and Richardson, 2011), but that avoiding taxes does not need to be beneficial to investors, as it also helps managers to divert income (see e.g., Desai et al., 2007; Desai and Dharmapala, 2009). These assertions are supported by a number of fellow researchers, who, from then on, include manager incentives into their research design (e.g., Dyreng et al., 2010; Armstrong et al., 2012). Third, the corporate context of tax avoidance allows an analysis of the influence of specific stakeholders. This rather new strand of research has brought forward interesting insights on how corporate tax avoidance is influenced, among other factors, by labor unions (Chyz et al., 2013), consultants (Lipatov, 2012) and their respective areas of expertise (McGuire et al., 2012), or lobbyists (Richter et al., 2009).

In parallel, researchers have become interested not only in explaining variations in their one type of proxy for tax avoidance, the ETRs, but also in different measures. On the one hand, there are incremental adjustments to the existing measures of corporate ETRs, in which either the measurement of the numerator, tax liabilities, or the denominator, a measure of pre-tax income, is refined. On the other hand, new proxies of tax avoidance, such as book-tax-differences (see e.g., Desai, 2003; Frank et al., 2009; Armstrong et al., 2012) or identified illegal tax shelter activities (see Graham and Tucker, 2006; Wilson, 2009) have emerged.[7]

[7] While Desai (2003) introduces BTDs (the differences between financial and tax accounting) as a proxy, others refine this measure and try to isolate accruals due to tax preferences, so as to not confuse observations with earnings management (e.g., Frank et al., 2009; Armstrong et al., 2012). Concerning tax shelter incidences, Graham and Tucker (2006) identify a sample of 44 firms, which were accused of illegal tax shelter activities. For this sample, they estimate the impact of engaging in shelter activities and link their occurrence to firm characteristics. Wilson (2009) builds on this approach, extends the sample, and tests for the moderating impact of corporate governance on consequences from sheltering.

The Need to Look Inside the "Black Box" of Tax Planning

We see that research on tax avoidance, and especially its identification, is growing but still remains "less than complete" (Boone et al., 2013, 53). On the one hand, there is to some extent consent that both firm and management characteristics have an influence on tax expense. On the other hand, research on the behavioral side of tax avoidance combining insights on the tax planning process and organization structure and tax avoidance is rather limited. Specifically, there are only few insights, if any, regarding how tax planning processes differ across companies and, in turn, how theses differences affect tax expense.[8] Hanlon and Heitzman (2010) point to selective questions of interest in this area:

"Perhaps a more fundamental question is who makes the tax decisions for the firm? What is the role of the general counsel in tax decisions? How much control do the top executives have over the tax director, and how is their performance monitored? What are the cross-sectional determinants that guide the balance of power [...]?" (Hanlon and Heitzman, 2010, 146)

Concluding this section, we motivate our research project as follows: Emerging from the above literature review, there is a very relevant research gap with regard to understanding in more depth the context and process of tax planning and how they affect the tax expense that a company incurs. We believe that a major problem in current research is the focus on publicly available, large-scale data, which permits only limited insights into how and why companies differ in their tax planning approaches. Our method of in-depth expert interviews allows us to gain this needed deep-rooted and comprehensive understanding.

3 Methods

Applying an analytic induction approach (Glaser and Strauss, 1999), we started with—implicit and explicit—initial "tentative hypothes[e]s to explain something" (Miles and Huberman, 1994, 147) about the influences on the tax planning process and tax expense based on the existing literature. We then went back and forth to accommodate new findings from our data into a generalized framework with the initial hypotheses being adjusted as new information was learned (Ahrens and Chapman, 2006). During this iterative process of theory development, data collection, and interpretation, we then applied the concept of theoretical sampling (Glaser and Strauss, 1999). Contrary to random sampling techniques, theoretical sampling is a purposeful, non-random (and often evolving) selection of cases which the researcher deems

[8] We think that it is important not to unidirectionally link evidence of tax avoidance to outcomes of tax planning, such as low ETRs. A current interesting example of a study that decouples the two is a working paper by Saavedra (2014), who shows that also firms with high ETRs can be tax-avoiders, with the only difference being that they are unsuccessful ones.

most valuable to advance his or her theory development (Onwuegbuzie and Leech, 2007). In our research, we work in a multiple-case setting, in which we interview members of different groups. Using these interviews, we aim to identify influencing factors on the tax planning process which can explain the observed large variation of levels of tax expense across firms, with the additional layer of the interviewees' background (Miles and Huberman, 1994).

Data Collection

Our main data are 19, mostly one-hour interviews conducted by the first author from April–November, 2013. Various research settings require different numbers of interviews to reach meaningful conclusions. From our perspective, the number of 19 interviews is sufficient, as all of our interview partners are widely knowledgeable experts in the area of tax planning, and thereby, we may have reached saturated data earlier than in other settings (Guest et al., 2006).[9] In total, we interviewed nine consultants, eight tax managers, and two representatives from German tax authorities (see TABLE 1). Details on the interviewees in each group can be found in Appendix 1 on p. 24.

[Insert TABLE 1 about here]

As is recommended, we followed a standard procedure for setting up the interviews (Gläser and Laudel, 2010): First, the second author established contact with the potential interviewee and gave a brief one-page introduction about the research project and research team. Then, the first author scheduled and personally conducted every interview to ensure consistency (Merchant and Manzoni, 1989). In total, 23 candidates were contacted. Consequently, more than 80% of candidates became actual interviewees.[10] All interviewees were interviewed only once and agreed to the interview being recorded. Each interview was subsequently transcribed for the data analysis. The language in all interviews was German, and all but one interview were conducted in-person at the interviewee's office.[11] The one interview being conducted via telephone took place with a person well known to the interviewer, and thus, no concern of a bias is assumed. Being "'glorified reporters' whose main role is to give an adequate account of

[9] In fact, 30 interviews generally suffice according to early sample recommendations for grounded theory (Morse, 1994; Creswell, 1998). As argued, we believe that for our expert group, a smaller number of experts, who have cumulatively served easily hundreds of companies, does not negatively impact our analyses and conclusions. A short-term cancellation, which could not be adequately replaced, decreased our targeted number of interviews from 20 to 19.

[10] All candidates previously known to the institute accepted the interview invitation, while "cold calls" uniformly failed. Since we do not know the exact reasons for non-participation, we can only speculate that time constraints/best use of time or confidentiality concerns were among the reasons. Our pre-established access to those experts makes our data unique and also sheds a positive light on the willingness to disclose even more sensitive information in these confidential interviews.

[11] All quotes in this paper have, as a consequence, been translated into English. Translations are mostly literal, except for metaphors used.

the informants' experience" (emphasis in original version, Gioia et al., 2013, 3), we focused on asking open-ended questions and framed most of them to obtain the interviewee's personal view. Conforming with general methodological practice (e.g., Bansal and Roth, 2000; Stigliani and Ravasi, 2012; Malina and Selto, 2001; Gendron and Spira, 2009), we primarily used the interview guide's eight broad topics to start and complemented with 17 follow-up questions, which include deep-dives or specific hypotheses that we anticipated (for the questionnaire see Appendix 1 on pp. 25 ff.). While our interview guide was intended to ensure that all/most intended questions were asked without narrowing down towards the end of the interview series (where the pitfall of trying to confirm rather than explore grows stronger), we kept taking up excurses and did not force topics. Put another way, we did not allow ourselves to be "handcuffed" by using an interview guide, but rather employed it to create structure and to "demonstrate competence" (Bogner et al., 2009, 64) and careful preparation, which is considered useful, especially in the case of expert interviews (Trincek, 2009). We opted to introduce the interviewer as an expert on a different subject (namely, scientific research) and also as a knowledgeable and to-be expert on the subject of tax planning to facilitate communication at eye level.

In the two main phases of our interviews (April–July and September–November, 2013), we performed two adaptations as a consequence of the theoretical sampling approach. First, we varied the mix of interviewees from each of the three groups to give us the opportunity to focus more or less on a particular group. Second, we altered the interview guide once following the completion of one interview phase to allow us to follow-up with conflicting evidence for our hypotheses and to understand still vague concepts in more detail.

In many cases, the interviewees—unknowingly—made comments about other firms in our sample. In order to further enrich and triangulate our interview data and construct the case studies in Section 5, we also took a total of 213 other data sources (e.g., annual financial reports, company publications, press articles) into account (Vaivio, 2008; Ittner and Larcker, 2001). TABLE 2 lists all data sources and uses.

[Insert TABLE 2 about here]

Data Analysis

First, following Mayring (2010), we conducted a qualitative content analysis based on the transcripts of the recorded interviewees' conversations. Given the exploratory nature of our work, we applied an inductive coding scheme as “data labels” (codes) emerged from the data, instead of developing a fixed coding scheme upfront. Apart from occasionally using “in vivo” codes directly from the interview transcript, we stayed very close to the interviewees’ expressions in establishing a first-order coding. As more codes accumulated, we fitted our coding into a hierarchy addressing context, process, and outcomes of tax planning with the respective aspects. In addition, we chose to document variations of a code by adding a sub-unit of analysis (e.g., assigning labels for different stakeholders to the code “interpretation of tax planning outcomes”, or differentiating key performance indicators [KPIs] of tax planning by different ETR constructs). A total of 130 unique codes (including such variations) were assigned. To ensure interrater reliability of the coding, the two researchers independently coded the interviewees’ answers for a representative part of one fourth of all coding performed across all subgroups (Miles and Huberman, 1994). In a first comparison, identical codes assigned to the same text passages represented more than 70% of all codes assigned. Subsequently, we discussed divergences in our coding structures and resolved most of them by mutual agreement and some re-coding. Often, those divergences were caused by a different classification of “technical” questions, such as classification of a specific tax-saving method, which were quite easy to resolve. This led to an overall increase in the consensus to 95%, which is notably above the recommended threshold of 80% (Miles and Huberman, 1994). Following a recommended procedure with analytic induction, we started to code towards the end of the first phase of our interviews (Miles and Huberman, 1994). This helped to focus emerging main themes to challenge, follow-up on open questions, and highlight contradictions for the subsequent interview phase. Based on this coding structure, we then built an intermediary holistic framework linking almost all codes from the coding scheme together and building summarizing categories. In a final step, we built the more abstract three-hurdles concept of tax planning introduced in the next section.

4 Findings – The Three Hurdles of Tax Planning

Based on the interviews, we present a holistic concept, which explains why some companies seem to effectively employ more tax-minimizing tax planning methods, while others seem to fail to do so. The three-hurdle concept as displayed in Figure 1 contrasts the traditional view of tax planning as a “black box”, in which influences from the organizational setting are not, or are not adequately, factored in. It disaggregates the process of implementing certain tax planning methods—which cause different levels of tax expense— into three hurdles. Only if all three hurdles are successfully overcome, will a tax-saving strategy be implemented and affect tax expense.[12] The sequence of the three hurdles represents the narrowing down of the choice from an "unscreened" set of all conceivable tax planning methods to an often much smaller set of actually implementable tax planning methods. The identification of these three hurdles, as well as their sequentiality, are derived from theoretical insights from the interviews and emerged through re-iterated coding and analysis.[13] We will take a deep-dive into each of the three hurdles in detail in the subsequent paragraphs before presenting five short, real-world company case studies, which help to operationalize and prove the applicability of our three-hurdle theory.

[Insert Figure 1 about here]

Hurdle 1 – Available Tax Planning Methods (Defined by the Business Context)

Which limits to, and opportunities for, tax planning does the business context provide?

Hurdle 1 is concerned with the mere availability of tax planning methods, as given by the business-specific context of firm characteristics (e.g., size, liquidity, profitability) and relevant regulation (e.g., thin capitalization rules, transfer pricing rules). The fact that these two business context factors influence tax expense is by no means new and has been acknowledged and investigated from the very beginning of tax planning research.[14] Early critiques, such as the one by Fiekowsky (1977), stress the potentially distorting effect of the regulatory context on how much corporate income tax is reported and paid. Consequently, researchers test the impact of specific changes in regulation on corporate tax expenses (e.g., for Germany: Haesner and Schanz, 2013; Overesch and Wamser, 2010; Buettner and Wamser, 2013). Along the same lines, tax research also quantitatively investigates the influence of firm characteristics (e.g., profitability, company size) on the level of tax expense (e.g., Stickney and McGee, 1982; Gupta and Newberry, 1997). Recently, a couple of papers have started to analyze in more detail how companies with specific firm characteristics can benefit more from given tax planning methods, for example, high investment firms

[12] We do not intend to express a normative stance with the three hurdles. As will be explained in more detail later, companies that consider certain tax planning methods to be undesirable may have good reasons to do so, and failure to include those methods in the relevant set for potential implementation does not necessarily mean that those companies are less effective in their tax planning.

[13] To challenge our conclusions, we have practiced what is known as "[c]hecking out rival explanations" (Miles and Huberman, 1994). Foremost, after having identified the three hurdles in their sequentiality, we have investigated whether they are rather a co-existent, instead of a sequential, concept. This exercise helped to sharpen the three hurdles in a way which also allowed for identical influences having an impact on different hurdles, such as financial position impacting both available, as well as desirable, tax planning methods. While a co-existent three-hurdle concept could also accurately explain the level of tax expense, we feel that the additional layer of sequentiality covers more adequately the evaluation process as shared by our interview partners.

[14] In that sense, the representation of Figure 1 shows that we "move" firm characteristics inside the "black box" as part of the explanation of what takes place at the company level of tax planning. As we will show later, firm characteristics also have an influence on at least hurdle 2, that is, the financial position's influence on the company's general aims and its ownership affecting values.

benefitting more from deferral tax planning methods (Ayers et al., 2011).

We would like to stress a few open issues pertaining to the question of the influence of the business context on tax expense. First, firm characteristics are not fully exogenously given, but are also subject to change, potentially also because of tax reasons. This endogeneity makes it difficult to separate planned tax-optimizing behavior and simple availability differences between companies. Based on the interviews, we suggest that, at least for German companies, the direction of the relationship is more strongly skewed towards business context influencing the availability of tax planning methods. This is exemplified by statements from the interviews on the main influencing firm characteristics from the business context in TABLE A1 in the Appendix (see pp. 30 ff.), in which the influence is often beyond the tax department's control, and can thus be regarded as predominantly exogenous factors. We conclude from the interviews that especially the factors of basic business model (service vs. goods), financial position (profitability and liquidity) and company size (country footprint and overall scale) are important prerequisites to render certain tax planning methods available to a firm. Regarding the influence of a firm's financial position, a consultant informed us that "Of course, multinationals also have possibilities [...] to use excess liquidity [...] in hybrid financing structures". On a different note, we learned that "[financing subsidiaries] will maybe make sense for an overall financing need exceeding 1 bn". Concerning the second aspect of the influence of regulation, we find that regulation can both provide opportunities for, and set limits regarding, tax planning. These opportunities and limits arise individually in connection with specific firm characteristics. Thus, uniform events, such as tax reforms, will have varying impact on different companies. For example, tax rate cuts will, in a one-off event, positively impact companies with deferred tax liabilities, while they harm companies with deferred tax assets. TABLE A2 in the Appendix (see pp. 35 ff.) displays the stance of our three interview groups regarding the influence of regulation via representative quotes.

Summarizing hurdle 1, we see that, in line with previous research, the contextual business influence from firm characteristics and regulation defines which tax planning methods are available. By formalizing this as hurdle 1, we make explicit what previous research has assumed and additionally strengthen the understanding that business influences taxes rather than the other way around. The implications are twofold. First, we need to take into consideration that some companies and their tax departments have—based on their context—simply more opportunities on hand to effectively manage taxes. Put differently, “the set of firm-specific variables available to explain actual tax avoidance activity is also likely correlated with opportunities to avoid tax” (Brown, 2014, 58). Second, this business context causes, at the same time, various effects which are non-influenceable by the tax department (e.g., payment of local non-refundable oil taxes). Concerning those, we should think about how to separate those biases from measures of tax expenses, such as ETRs, before using them as proxies for the success of tax planning and as measures of tax avoidance in quantitative analyses.[15]

Hurdle 2 – Desirable Tax Planning Methods (Based on a Company's Aims of Tax Planning)

Which tax planning strategies are desirable based on a company's aims of tax planning?

The next hurdle determines if generally available tax planning methods are compatible with the company's aims of tax planning. Consequently, hurdle 2 limits the set of tax planning methods further by eliminating methods which are available, but not considered desirable. We find that aims of tax planning are primarily driven by two factors: corporate values and firm priorities. Our interviews revealed that companies feature a broad range of tax planning aims which differ in terms of the object of aims (income taxes, total taxes, duties, cash taxes, GAAP taxes, etc.), the optimization function (minimize, stabilize, etc.), and the benchmark to which to compare it to (peer performance, own past performance, own forecasts).

Corporate Values and Tax Planning Aims

The influence of corporate values seems to be rather long-term, while priorities are subject to more frequent short-term changes. Even our moderate sample of interviews reveals that corporate values with regard to tax planning can take very different forms. We identify a spectrum that ranges from pragmatists, for whom many tax planning methods would work from a values perspective but their implementation with the operating business proves to be the true hurdle, to moralists, who value tax payments as a societal duty, especially to the local community (see TABLE A3 on pp. 36 f. in the Appendix for comprehensive range). It is interesting to reflect on the origin of those values. The quotes show that in some cases the interviewees emphasize the influence of a specific person (e.g., a company owner, a manager) on the guiding values of a company. This impact of personal values on the corporate environment has been

[15] As a first attempt to separate different effects driving a company's ETR, Inger (2014) decomposes ETR changes into three different sources of tax avoidance activities and a residual component. While this approach grasps the different categories of ETR differences in more detail than previous efforts, it still cannot account for the origin of those differences, that is, if higher depreciation allowances are actively generated to save taxes or merely part of the business model.

subject to extensive research in different areas of management science.[16] For a major part, there is a view that "individuals can, indeed, make a difference" (Hemingway and Maclagan, 2004, 33) via their personal values. First attempts to investigate the role of values in empirical tax avoidance research manifest themselves in proxies, such as religion (Boone et al., 2013) or military background (Law and Mills, 2013) as determinants of corporate tax avoidance. While these studies provide first answers to which values seem to be relevant, we encourage further investigation into the role that personal values play as a decision criterion in the gray areas associated with tax planning.[17]

Firm Priorities and Tax Planning Aims

Our interviews suggest that general firm priorities can change more frequently, and also on rather short notice. We see especially the financial position and profitability situation as causes of a reprioritization of the aims of tax planning. Anecdotes from the field have always supported a view that GAAP (Generally Accepted Accounting Principles) ETRs are much more important for public companies than cash taxes. While this lack of importance is supported by a survey of Graham et al. (2014), academics utilize the cash ETR as a—or the—proxy for tax avoidance (e.g., Chen et al., 2010; Armstrong et al., 2012; Cheng et al., 2012; McGuire et al., 2012; Boone et al., 2013). We also find that privately owned companies pay more attention to cash taxes, while public companies focus on GAAP ETRs. As a new aspect, we find that priorities can change even for public companies towards management of cash taxes in case of liquidity shortages, as already shown by the quotes in TABLE A1 in the Appendix (see pp. 30 ff.).

Our overall findings for hurdle 2 are threefold: First, assuming a general tax minimizing strategy is certainly not true for all companies. Thus, comparing outcomes of tax planning uniformly on the basis of a single indicator, such as the level of ETRs, might lead to false conclusions. Second, we find that the spectrum of tax planning aims is not black and white (i.e., tax avoider vs. tax administrator), but rather a blend of different aims. This expands previous pioneering studies on aims of tax planning (see Robinson et al., 2010). Third, considering the wide range of different aims of tax planning, it seems a valid conclusion that aims themselves can reveal a more direct and undisturbed view of a company's

[16] Research on the congruence of personal and corporate values has often led to conflicting evidence regarding the importance of such congruence and how it develops (Ilangovan and Durgadoss, 2009). A substantial part of the research is theoretical and tries to develop decision-making models for topics such as corporate social entrepreneurship (Hemingway, 2005), philanthropy (Jones, 2007), or sustainability (Kaldschmidt, 2011).

[17] In what could be interpreted as values in a broader sense, Chyz (2010) finds that private tax aggressiveness is correlated with higher measures of corporate tax avoidance. We think that it will be valuable to understand more completely how such attitudes are subsequently translated into behavior. We can only hypothesize that such increased aggressiveness could lead to more tax manager power benefiting the implementation of tax planning methods, as analyzed in Section 4 regarding hurdle 3 of tax planning.

aggressiveness in tax planning and the intention to avoid taxes.

Hurdle 3 – Implementable Tax Planning Methods (Driven by Tax Manager Power)

Which tax planning strategies are implementable because of tax manager power?

The last hurdle that a company must overcome to feature a certain tax planning method is that the tax manager is powerful enough to successfully implement it. We find that this tax manager power is driven by both the organizational power of the tax department and also individual power related to the person of the Head of Taxes.[18] The underlying reason for tax manager power being such an important factor is that many—if not most—tax planning methods require a change not only on paper, but a real change in how a company conducts business, that is, a change in substance (Schanz and Schanz, 2011). This ex-ante change often implies additional work for other functions in the company and is likely to be opposed. In accordance with insights from power research (e.g., Mintzberg, 1983; Brass, 1984; Astley and Sachdeva, 1984; Finkelstein, 1992; Ibarra, 1993; Mitsuhashi and Greve, 2004), we acknowledge that power can emanate from various sources. In the context of tax planning, we identify four sources which help to create and maintain tax manager power: internal formal power, internal informal power, external reach, and capabilities. They are summarized in TABLE 3 below.

[Insert TABLE 3 about here]

Some of our findings on tax manager power can be related to existing knowledge on power from social science research. To begin with, Kanter (1979) names three sources of power related to supply, information, and support. The latter two can be matched to our insights that power-increasing mechanisms involve informational advantages and strategic alliance building with other corporate functions. Finkelstein (1992) establishes four categories of power (structural, ownership, expert, and prestige power) which can to a large extent also be related to our categories. We will now examine each of the four categories in detail and continue linking our findings to existing power research.

Internal Formal Power

Literature on organization structure and on power reveals that organization affects the behavior of individuals, and that organization has an impact on company performance (Dalton et al., 1980). Following

[18] To be precise, one still needs to distinguish mere access to power ("potential power") and exploitation thereof ("exercised power"). In the remainder of this paper, we always mean the combination of those two distinct phenomena when describing tax manager power.

the interviews, we also identify the extent to which the formal power of tax departments is organized as a substantial influence on successful implementation of tax planning (underlying quotes from the interviews are in TABLE A4 on pp. 38 f. in the Appendix). The hierarchical level, as well as the formal decision-making authority, are evident tools to increase tax manager power. More subtle influences are the use of specific after-tax targets for the tax department, which may even be linked to a part of the salary. These specific targets increase power in two ways. First, they empower the tax department as the true guardian of the owners' interests who are from a theoretical perspective interested in maximizing after-tax cash flows (corresponding to "ownership power" in Finkelstein, 1992). Second, the incentive link to after-tax results will likely result in the transformation of potential power to exercised power—a important difference in power research. Furthermore, since we know that power is a relative concept, we must also analyze how the other units in the organization are arranged (Kanter, 2001). In particular, not only do tax incentives of the tax department matter, but also the degree of alignment of those tax interests with the rest of the business. Thus, we support previous research that the incentives on a pre- or after-tax basis of business units and top management are a crucial factor to the extent that it shifts power towards tax managers. The more institutional conflicts there are in an organization, the less likely it is that tax managers can successfully implement tax planning strategies, which often come at a pre-tax cost (e.g., consulting fees) and yield only after-tax benefit. As an example, a tax manager informed us that "[y]ou always have the conflict that consulting fees lower operating income but increase EPS—if you spend it wisely. That leads to conflicts of interest."

Internal Informal Power

Concerning the more informal parts of tax manager power from organizational sources we identified in our interviews, some have been subject to first investigation in the academic literature. Regarding the importance of relationships to top management, Hilger et al. (2013) examine career implications of ties between the Chief Executive Officer (CEO) and members of the top management team. We learn from this study that personal relationships matter a great deal in a business context and can lead to more likely career advancements in case of good relations. Thus, personal relationships will probably matter in decisions on tax issues as well. In general, the quality of internal relations seems to be driven by the reputation of the Head of Taxes and his or her staff. Based on the interviews, we find that companies have very different perceptions of both the ideal and actual form of collaboration with the tax department and its usefulness. In this regard, the challenge for the tax department is to strike a good balance between corporate control and partnering with the business. A tax department which focuses too much on “being a good business partner”, will likely be too understanding regarding why certain tax planning ideas cannot be implemented, while a focus on corporate control can either lead to a strict adherence to compliance work (where formal authority is often a standard) or to extreme difficulties to create business unit cooperation.[19]

External Reach

We find that tax manager power increases in the extent to which relations outside of the organization are maintained. Those relations with the fiscal authorities, tax consultants, or other Heads of Taxes serve different purposes described in TABLE 3. This source of power can be related to two power dimensions by Finkelstein (1992). To begin with, it can be viewed as expert power because it gives tax managers access to other experts, thereby broadening the extent to which they can bring relevant knowledge to the company. Finkelstein (1992) does not restrict expert power to its functional character, but rather stresses the fact that it is the general expertise to deal with critical contingencies (e.g., via appropriate knowledge, or via important relationships) which empowers. Therefore, maintaining relationships, especially with tax consultants and the fiscal authorities in order to acquire knowledge about innovative or controversial tax planning schemes, increases tax manager power and, thereby, the likelihood that such tax planning methods will subsequently be implemented. In the latter sense, external reach also constitutes prestige being summarized as “a manager’s ability to absorb uncertainty from the institutional environment” (Finkelstein, 1992, 515). The causal mechanism by which prestige increases tax manager power is direct and indirect. The direct one has just been explored and describes the fact that relationships to important people outside of the organization can help to access information and knowledge. The indirect effect affects how people within the organization respond to a manager with strong external ties. Finkelstein (1992) stresses the fact that status symbols, such as relations to powerful people, will influence the mere perception of power of that person, thereby in turn causing it. We find evidence for both mechanisms in our interviews. On the one hand, tax consultancies are often used as idea generators for new tax planning

[19]In the neighboring research field of management accounting, research on the resembling special role of management accountants and characteristics of so-called “strong controllers” is well-established (Sathe, 1983). Similar to our findings, there are also differences in the quality of co-operation between management accountants and operational managers (Ahrens, 1997). Regarding different interaction types, Maas and Matejka (2009) show that controllers’ exaggerated focus on their corporate duties can actually lead to worse performance in terms of misreportings because of role conflicts and ambiguity.

methods or serve as providers of information on tax law changes in the countries in which a company operates. On the other hand, tax managers report that external credibility for tax planning ideas—either via tax consultancy advice or by providing examples from tax planning methods implemented at other companies—can lead to higher acceptance of such proposed tax planning methods.

Capabilities

The final category of tax manager power stems from the individual capabilities of the Head of Taxes. While some researchers reduce the influence of individuals to the structure in which they operate in an organization (e.g., Brass, 1984), others analyze the different means that individuals have to assume power in a given organizational environment (e.g., Kipnis et al., 1980). As Kanter (2001) points out, accumulating power in organizations is driven by two specific skills: First, the individual needs to have the ability to contribute in a unique way, which means that his or her results are based on special judgment and cannot be easily automated. Second, the individual needs to be able to successfully join networks of power. Building on these insights, we summarize the prerequisite capabilities of gaining and maintaining tax manager power into two aspects: expert functional knowledge and social skills.[20] Expert functional knowledge related to tax norms does not come as a surprise. In the context of tax planning, most associations relate to a rather technical job description characterized by a "context of complexity [and] rapid change" (Epps et al., 2010, 35), in which accuracy and strict protocol for documentation have to be followed. The more insightful part therefore concerns the importance of social skills for tax staff, and especially the Head of Taxes. We learn from the interviews that his or her ability to communicate with the business units (e.g., "speaking their language" instead of tax jargon) can make a huge difference in being accepted by the operating business units, thereby obtaining necessary information early (e.g., about M&A transactions).[21] Meanwhile, these communication skills are also necessary for effective upward communication and relationship building with the decision-makers, such as the Chief Financial Officer (CFO). Individuals who are better at approaching others proactively also benefit from early inclusion in all relevant processes; this helps them to plan their resources efficiently and achieve the targets of their

[20] As expressed by the term "prerequisite", we regard these characteristics especially as enablers to create tax manager power in the structural setting as described in the paragraphs above. One could therefore argue that it does not represent a fourth category of power in itself but functions as a facilitator. We, however, agree with Finkelstein (1992), who sees expert power from critical knowledge as a separate category.

[21] A similar thought is raised in the analysis of causes for outsourcing the tax department by Lerner and Levine (1993). They mention communication skills as a key asset and attribute existing problems to the fact that "[m]any tax professionals do not talk in terms their CFO and CEO understand. They talk about Code sections, regulations, and court cases." (Lerner and Levine, 1993, 376).

tax planning efforts.

Overall, our evidence suggests that there are various ways to combine specific formal organizational characteristics of power into successful packages, while the effect of single practices can be ambiguous.[22] Similarly, we also observe that often certain choices regarding how to design the process of tax planning co-occur. For instance, managers with concrete KPIs often have a part of their salary linked to these KPIs and, in turn, receive procedural rights, such as vetos, early involvement and required approval signatures, in order to enable them to really own (at least a part of) the tax planning process and ultimately influence tax expense. This insight provides new explanations of, and possible changes in, interpretations of existing research. We have mentioned that a number of researchers tested the impact of managerial incentives, such as bonus payments for tax managers linked to the ETR, on measures of tax avoidance (e.g., Phillips, 2003; Desai and Dharmapala, 2006; Armstrong et al., 2012). Given our insights from the interviews, we can provide enhanced explanations of the causal link between incentives and tax avoidance behavior. A likely expansion is that not only the incentives, but also a typical co-occurrence of necessary organization design, which gives tax managers the power to influence the tax planning process which leads to different levels of tax expense across companies.

5 Case Studies to Operationalize the Three-Hurdle Theory in a Real-World Context

We now present five real-world, anonymized company case studies, which apply the three-hurdle concept and operationalize each hurdle with specific empirical measures, including additional public information in excess of the interview data. Our aim is to link the assessment of how these firms approach hurdles 2 and 3 (measuring a score for each firm) to the firms' tax expenses.[23] On the one hand, this should be viewed as a proof of concept of how the three-hurdle theory performs with real-world examples, and on the other hand, it also constitutes a suggestion of further empirical tests (Yin, 2009). In choosing the five companies for our case studies, we focused on large, public German, internationally operating firms from different industries.[24] We concentrate our analysis on their differences for the newly identified

[22] This concept is closely related to "bundles" in HR management, which refer to clusters of individual HR practices grouped by the goal of HR management, the degree of involvement of the HR function, or area of HR work (Toh et al., 2008). The shift from evaluating the success of individual HR practices, such as trainig by instructors vs. training via video, towards analyzing comprehensive sets of practices with a common goal occurred in the mid-1990s. First, MacDuffie (1995) analyzes how sets of HR practices improved manufacturing performance in the auto industry. More general research on the impact of HR bundles soon followed (see e.g., Huselid, 1995).

[23] Using the verb "approach" indicates that we include the possibility that the observed variation in scores of the two hurdles is actively chosen by the companies for reasons that we cannot directly observe.

[24] These companies constitute a subset of the companies whose tax managers we interviewed. The other three companies were dropped since they had distinctive features and are not German blue chip companies (DAX). This preselection reflects general methodological practice that "[c]ases cannot simply be idly lumped, summarizing 'similarities and differences' on some common variables of interest" (emphasis in original, Miles and Huberman, 1994, 208).

hurdle 2—aims of tax planning—and hurdle 3—ability to implement tax planning—where the companies could at least theoretically exhibit the same properties, and implicitly control for hurdle 1 by comparing their tax expense to their small peer group of similar industry, size, and international activity (based on peers listed on the Worldscope Financials database and additional peer companies mentioned in the interviews).

Measures of Hurdle 2 ("Desirable") and Hurdle 3 ("Implementable")

The case studies can independently provide evidence of the plausibility and applicability of our three-hurdle theory given that we develop empirical measures of hurdles 2 and 3—collecting additional publicly available data—and link those measures to the actual tax expense of those companies. To render our case studies more easily comparable, we consolidate the different empirical measures of hurdles 2 and 3 into a score of the aggressiveness of tax planning aims (hurdle 2) and a score of tax manager power (hurdle 3). We operationalize the score for hurdle 2 based on three sub-elements: Perception of the tax department in the organization (similar to Mulligan's concept of tax embeddedness), explicit objectives of tax planning, and evaluation of tax planning outcomes. The information for these three elements comes mainly from the interviews with infrequent consultation of annual reports or other publications that revealed something about the aims of tax planning.[25] Hurdle 3 was measured along the four power dimensions, which we identified through the interviews (internal formal power, internal informal power, external reach, capabilities).[26] This hurdle being the newly identified influence on how companies approach tax planning, we further decomposed these four categories of power into empirically measurable variables, also from additional public information, in accordance with the theoretical insights from the interviews (see TABLE 3).[27] Figure 2 summarizes how the five companies score on the two hurdles.

[Insert Figure 2 about here]

We generate interesting insights into both the single scores, as well as the correlation of the two. First, we see that companies vary widely both in terms of their aggressiveness of tax planning aims (x-axis) as well as in the tax manager power (y-axis). The Arrow Corp. exhibits the highest score of tax planning

[25] TABLE A5 on pp. 41 f. in the Appendix provides evidence of the aims of our five case study companies from underlying representative quotes.

[26] Details on how the scores are measured is given on pp. 40 ff. in the Appendix.

[27] Internal formal power was measured by the existence of formal guidelines, KPIs of the tax department as well as those of top management and the operating functions. Internal informal power was proxied by the relations to the CFO, alliance building with staff functions, and business sense to effectively work with the operating functions. The score of external reach consisted of representation in relevant associations, prior positions, and the consulting network. Capabilities were proxied by tax-specific publications, lecturing at universities, and study background.

aims by far, while companies, such as the Circle Corp. and the Balance Corp., regard tax planning either more as a necessary hygiene or a social responsibility than a value-adding activity. Although the distribution of power scores is much more narrow, there is still a noticeable range. Again, the Arrow Corp. features the most powerful tax manager, while companies such as the Circle Corp. have only half of that tax manager power score. Indicated by their position above the diagonal line, the Circle, Balance, and Star corporations achieve a higher share of the total obtainable score for power compared to their relative score on aims which could indicate that they are successful at achieving their—albeit modest—aims of tax planning. To analyze the origins of these differences, Figure 3 provides more information on how those scores are added up from their sub-elements.

[Insert Figure 3 about here]

First, we see that while there is a generally positive correlation of tax planning aims and tax manager power of 0.82, especially the Tile Corp. seems to strive for aims of tax planning, which cannot be matched by the power of its tax department. This should result in failure to achieve the desired aims of tax planning. Second, the three proxies for aims of tax planning are all highly correlated with the overall score, while similar power scores can draw on very different elements. Interestingly, the power proxies drawing on publicly available information exhibit best fit with the overall tax manager power score.

Tax Expense as a Result of Aims of Tax Planning and Tax Manager Power

We will now take a brief look at how these differences in aims of tax planning and tax manager power translate into different levels of tax expense. Expecting a variety of aims of tax planning as identified during the interviews, we analyze not only the level of tax expense, but individually different measures for each company: the level of relative tax expense (ETRs), as well as intra-year and year-on-year volatility of ETRs, all in relation to the respective peer group of a few large, international companies in the same industry. Moreover, we consider how companies communicate these results of tax planning externally to investors using earnings calls' (EC) transcripts. We focus on ECs since interviewees said that this was the single most relevant source of communication about taxes. TABLE 4 contrasts the original aims of tax planning with the actual achievements.

[Insert TABLE 4 about here]

We see that in most cases actual tax expenses and communication thereof can be reconciled with original tax planning aims. Low degrees of tax manager power are seemingly still enough to achieve even lower aims of tax planning. In the case of the Tile Corp., it is likely that low tax manager power explains the failure to achieve the desired aims of tax planning. A remaining puzzle is the Balance Corp., which, despite low aims of tax planning and low tax manager power, achieves quite remarkable results among its peer group, but consistent with its modest aims of tax planning communicates little to investors. Possible explanations for this puzzle might be that this company has extraordinary available tax planning methods from its business context (e.g., tax losses) that distinguish it drastically from its peer group. To summarize, we can clearly see that firms vary in their aims of tax planning and tax manager power to achieve them. Furthermore, it becomes evident that levels of tax expense are not the only relevant outcome of tax planning, and a more holistic view is needed. Overall, these case studies thus provide a better understanding of tax planning strategies and how they are implemented.

Concerning the empirical measurement of the three hurdles, we have two important conclusions pertinent to further large-scale studies of the topic. First, external communication about taxes in our case studies mirrors the original aims of tax planning very well and could thus be used as a proxy for the generally unobservable inside information about aims of tax planning. Second, the sub-elements of power which draw on externally available information exhibit very high correlation with the overall power score. This means that we can probably proxy for power quite reliably based on external information which should facilitate further large-scale testing of our three-hurdle concept.

6 Discussion and Conclusions

We contribute to the ongoing academic and public debate about tax avoidance by proposing a more comprehensive theory which explains varying tax expenses of multinational companies. To begin with, we systematize insights from 19 expert interviews into three hurdles of tax planning which explain why companies do not uniformly employ the same tax planning methods. This three-hurdle concept helps us to more precisely attribute causes of the observed large variation in tax expenses to the different influencing factors inside and outside of the company. The three hurdles encompass which tax planning methods are: available in the business context (hurdle 1), desirable from the company's aims of tax planning (hurdle 2), and implementable in the company due to tax manager power (hurdle 3).[28] For a long time, existing

[28] We cannot generally say that passing all three hurdles is in any way optimal or an indicator of successful tax planning. Variation across firms, as exhibited by the case studies, can also imply that companies face different costs and benefits of

research has focused on firm characteristics, which mostly determine hurdle 1. Our three-hurdle concept incorporates that stream of research, as well as insights on "skill" and "will" of managers to avoid taxes. Moreover, we add the entirely new factor of tax manager power, which determines whether or not certain tax planning methods can be implemented in the company. In order to operationalize the three-hurdle concept and provide a first empirical proof of concept that it can be applied to the real-world, we develop five company case studies. In these case studies, companies exhibit substantial variation in how they approach hurdles 2 and 3, that is, how aggressive their aims of tax planning are, and how pronounced the tax manager power is. Thereby, we provide convincing evidence that the level of tax expense is not simply a function of certain firm or management characteristics, but that the complex organizational setting matters, too. Generating the main part of our data from interviews with tax managers at different multinational companies, as well as experienced senior consultants with a large number of clients, we are confident that the results bear a generalizable value.[29]

Limitations

A first obvious limitation is that we have to take the information from the interviewees at face value, and that the nature of our chosen methodology limits the inquiry to 19 interviews. There are, however, some aspects making us confident that the information from the interviews is reliable. First, while all interview partners were German, the companies that they worked for/with are all large, multinational enterprises. Thus, our insights are also pertinent for a general assessment of what influences those multinational firms in their tax planning considerations. Second, we have fully transcribed the interviews, including pauses, repetitions, and corrections. Even when answering potentially precarious questions, interviewees did not change intonation or pauses, or give any other indication that they told a (partial) lie. Third, we triangulated our findings both across interviews and with the help of the additional data sources in the context of our case studies. A second limitation is a potential endogeneity problem between aims of tax planning and the actual tax expenses due to tax managers' ex-post rationalization given observed levels and volatility of ETRs. However, since we developed an independent score of the tax planning aims based on different components of the interview and did not use the direct answer to that question from the interview, we feel that this problem might be mitigated. Additionally, the fact that in two out of five cases (Balance Corp. and Tile Corp.) outcomes do not fit the original aims of tax planning

tax planning, for example, because they have different corporate values.

[29]So do informal talks with an American partner of a Big Four audit firm, who confirmed especially the influence of power.

(once outperforming, once underperforming) signals that responses did not necessarily suffer from such as bias. Finally, we still rely on accounting concepts, such as the ETR, in our case studies, even though the explanatory power is limited. We try to mitigate the effect by analyzing the ETR more holistically as we examine both levels of ETRs, as well as volatility measures. Moreover, our case studies demonstrate that in cases where the ETR is specifically targeted, one can meaningfully interpret it as a performance measure of tax planning.

Implications for Future Research

A logical next step is testing our theoretical concept on a larger scale with more empirical evidence for both Germany and other countries. We would like to highlight three specific areas for further research. First, in order to address the potential endogeneity concerns between aims of tax planning and the observed tax expenses, we suggest to investigate more specifically failed tax planning implementation. In such a setting, selecting those situations and identifying their causes automatically separates the desired from the actual outcome. This same investigation would also shed some light on the relative importance of each hurdle for failure to implement certain tax planning methods. Second, our theory suggests that tax manager power is the key variable for passing hurdle 3 to implement tax planning methods. However, many of the identified power attributes relate to tax managers, who are all relatively powerful given their position in large, multinational companies. We need a deeper understanding of whether additional (or different) attributes apply to tax managers in other settings (e.g., small firms, private firms). In addition to the correlation analysis of the power elements that we already identified, we also think that the identification of minimum thresholds and saturation points of tax manager power will enhance our understanding of the interplay between hurdles 2 and 3 in particular.

Appendix 1 – Information on Interview Partners and Interview Guide

Interviews with Tax Consultants/Lawyers

The first group of interviewees comprises a total of nine tax consultants at the partner level of their firms. We interviewed six consultants from "Big Four" audit firms (Deloitte Touche Tohmatsu, Ernst & Young, KPMG, PriceWaterhouseCoopers), and top-tier law firms, who are likely serving many of our sample firms in focus, namely large German multinational companies (DAX). The other three interviewees work at other renowned tax firms serving German listed companies. Tax consultants being a relatively homogeneous group, this sample size can be considered sufficient (Guest et al., 2006). In addition, there is a certain "multiplicator effect" since tax consultants have exposure to a multitude of companies.

Interviews with Tax Managers

Furthermore, we interviewed a total of eight experienced tax managers in the position of "Head of Taxes" or equivalent. This position features the role description of full responsibility of both tax accounting and tax planning. We conducted four interviews with Heads of Taxes and one with a tax manager working in the Global Tax department at German DAX companies, and three interviews with Heads of Taxes at other German multinational firms. Compared to the previous group, we spent a larger amount of the interview time examining the actual tax planning process. In order to achieve data saturation (recommended size of 12–20 data sources, see Guest et al., 2006), we took further in-depth data on each company into account.

Interviews with Representatives from Tax Authorities

Our final interview group comprises two representatives of the German fiscal authorities to ensure a 360 degree view of tax planning in Germany. During these interviews, the focus shifted away from internal company aspects, such as processes, roles, responsibilities, and incentives towards how tax planning is externally interpreted, and which link interviewees made to the phenomenon of tax avoidance. Furthermore, these interviews revealed interesting observations on the interaction of the previous two stakeholder groups of tax managers and consultants. While the number of two interviews is certainly not at the upper end of a desired sample size, we still feel that the insights gained are worth being included in our findings. Despite the non-representativeness, which we do not deny, we found a high degree of consistency among the two interviews, which gives us confidence about the relevance of those findings.

Interview Guide

The following interview guide is the version used since the beginning of the second phase of the interviews. It was adapted from the first phase of the interviews and structured into a "context-process-outcomes" framework as this pattern emerged. The first interview guide featured similar questions (eight open-ended questions and 16 follow-up questions). First, we listed all open, explorative questions and second, we formulated detailed follow-up questions. Since we learned from the first phase that asking follow-up questions directly was oftentimes helpful, we put those detailed questions, as well as open hypotheses from the first phase, directly into each section of the interview guide.

Interview Start

Background of the Interview

- Dissertation at Prof. Schanz's chair of Taxation and Accounting at Ludwig-Maximilians-Universität Munich since Fall, 2012;
- General topic is tax management in Germany and empirical research in that field;
- First research project/pre-study: tax management and ETR patterns in Germany;
- Detailed interviews with tax experts: Heads of Taxes, consultants and tax authorities, and all answers are to be anonymously evaluated in aggregated results only.

Aim of the interview

- Personal evaluation of: What is good tax planning? And how can we measure it?
- Which circumstances promote an effective tax planning process? Which hinder it?
- Which process variants of tax planning exist? Which activities, decisions, and roles? What are the consequences for outcomes of tax planning, such as absolute tax expense?

Main Part

Outcomes

- Clarifying definitions: What is optimal tax planning from the companies' point of view?
- Which aims do companies pursue regarding taxes in general? What is subject to optimization? Are there differences between companies?

Context

- Which circumstances promote the aims of optimal tax planning?

- Which circumstances hinder the aim of optimal tax planning?

  Details for follow-up:

  - How do you rate the influence of specific people of the company on tax management?
  - Are there any external influences or people that influence the process and its outcomes?
  - What is the role of the local environment (e.g., municipalities, residents) or politicians?
  - What is the role of management (top management vs. middle management), auditors/accountants, and customers?
  - What is the influence of ownership structure (institutional, governmental, private investors/family-owned)?
  - Does the operational business influence tax planning, or the other way around? In which cases?
  - What influence do incentives have? Compensation of managers? Differences between companies?
  - What roles do punishment and risk of detection play regarding tax planning methods?
  - How do you decide on a strategic "risk appetite" for the tax department? Adoption of general company risk level?

  Hypotheses for further testing:

  - There are internal (company) vs. external (legislation and society) influences.
  - Legislation is the framework within which tax optimization takes place.
  - Comparison of U.S. companies and German ones: ETR seems to be lower in the U.S. than in Germany. Why is that the case?

Process

- *Activities and methods*

- In what way is a target for the tax department developed? How is it communicated?

Details for follow-up:

- How do you distinguish between elements, which are considered "influenceable" by the tax department and those which are not?
- Do you achieve an "all-cost" perspective on taxes incurred? If yes, how?

- What is the planning and implementation horizon of tax planning? When do changes become effective?
- What does a life cycle of a new tax planning method look like? Who has the idea? Who are early adopters?
- How is the interaction with the operating functions managed? (e.g., how often? in what kind of format?) Why are there differences?
- What about the interaction with tax auditors? Which factors determine this relationship?

  Details for follow-up:

  - Cross-border businesses: What is today's attitude of the tax authorities/governments towards companies? Have procedures become more rigid, so that companies cannot save that much compared to the past? If yes, since when? What do companies do against that?

- How do you judge the relationships to government and politics? What about "proximity to politics" as an explanation for different tax expenses?

  Hypotheses for further testing:

  - There are many tax planning methods, particularly financing structures are useful, but they need a certain scale of the company.
  - Foreign tax rate differential is seen as the largest driver of ETR fluctuations.
  - Is there a differing "proximity" to tax auditors? Which strategies do companies pursue to obtain judgement on riskier tax strategies?

- *Roles and decisions*
- Which different roles exist in tax departments? Which one is typical? How does task division between consultants and employees of the tax department change?

- What are typical decisions that the tax department is involved in or should be involved in?

  Details for follow-up:

  - Which part of power of decision making is formalized, and which part is not? Why?
  - Which organizational elements determine to what extent the tax department is involved?
  - How do you solve target conflicts concerning tax minimization/ETR minimization vs. other company targets (e.g., higher absolute annual net profit)? What is the influence of tax managers in that case?

- How do you rate the importance of knowledge regarding tax optimization structures—internal and external?

Outcomes

- *Key performance indicators*
- What KPIs do you know to be used by (top) management? How are they used (for what purpose, how often, etc.)?

  Details for follow-up:

  - Cash vs. total ETR: Which is important when? Differences between companies?
  - Is there an ideal KPI or at least an internally used KPI, which is better suited?

  Hypotheses for further testing:

  - Targets and choice of KPIs depend on context and organization design and are not independent thereof.

- *"Real consequences"*
- What is the contribution of the tax department to the company's overall profit targets?
- How is the risk of additional expenses due to tax audit managed? Are there differences in dealing with the authorities between companies? Why?

  Details for follow-up:

- What kinds of experiences have you had regarding negative news about taxes and the reaction of external stakeholders?

- *Interpretation of outcomes*
- What aspects do stakeholders value with regards to tax management? Which KPIs? What about the existence of "red flags"?
- How do external stakeholders (investors, customers, auditors) interpret the tax results?

  Details for follow-up:

  - What kind of differences are there regarding companies in B2C businesses, etc.?
  - Is there a corporate aim to be regarded as a "good corporate citizen"?

Closing of the Interview

- Thank you very much!
- Would you mind answering further questions if any might occur later?

Appendix 2 – Three-Hurdle Concept as Identified in the Interviews

Hurdle 1 – Available

Influence of Firm Characteristics on Tax Planning

As argued in the main part, hurdle 1 consists of the mere availability of tax planning methods as per the business context from firm characteristics and regulation. To provide evidence, we cluster the main influences from the interviews with the nature of the influence on tax planning and cite representative quotes to justify our evaluation in TABLE A1.

TABLE A1
Influence of firm characteristics on the tax planning process and tax expense

Characteristic	**Nature of influence**	**Exemplary quotes**
Business model – General	*Permanent influence* on tax expenses, which is partly influenceable by the tax department (e.g., by reorganizing functions). *Higher complexity* of the business model (e.g., more products) more difficult to manage, needs *more tax planning.*	"Service firms do not have substance, they only sell their services. In manufacturing companies, you can allocate profit; for services, prices are globally uniform." (tax manager) "For [companies like] insurers, you have to differentiate in how far are their products driven by tax considerations – mostly very much so – and in how far is the company driven by tax considerations – mostly much less so." (authorities) "If you have a one-product business, you can optimize much more precisely." (tax manager)
Business model – Country footprint	*Permanent influence* on tax expenses and partly influenceable by the tax	"Doing business in countries with high statutory tax rates will not remain without consequences on the ETR – at least for German companies." (consultant)

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TABLE A1 – *Continued from previous page*

Characteristic	Nature of influence	Exemplary quotes
	department (e.g., via transfer prices). *Larger geographic dispersion* tends to allow for *more tax planning.*	"I have a certain country mix of subsidiaries and associated companies, which bring their consolidated profit into the holding company, thus, I also have different tax rates." (tax manager) "I can somewhat influence the foreign tax rate differential via transfer pricing." (tax manager)
Business model – Size	*Permanent influence* on tax expenses, which mainly defines available tax planning methods. The *larger a company*, the *more tax planning opportunities* via increased number of available methods.	"If a small business owner tries to set up a financing arm, he will soon know his limits as the related cost to create the necessary substance will easily outweigh potential tax savings." (consultant) "[Financing subsidiaries] will maybe make sense for an overall financing need exceeding 1 bn." (consultant)
Business model – Industry	*Permanent influence* on tax expenses (e.g., via special industry effects). *Defines peer companies* for ETR benchmarks or other comparisons of tax planning outcomes.	"You can say that the less direct work in the sense of manufacturing activities a company needs, the more they are prone to those schemes [tax haven subsidiaries]." (authorities) "As an example, in the pharma industry, even tax staff needs to know the phases of developing a new drug. Everybody needs this set of knowledge, otherwise it is difficult or even impossible to perform effective tax planning." (consultant)
Business model – Growth strategy	*One-time, but often repeated, bidirectional* influence on tax	"In the past, extreme ETRs were often caused by M&A deals." (tax manager)

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TABLE A1 – *Continued from previous page*

Characteristic	**Nature of influence**	**Exemplary quotes**
	expenses. Companies with *higher M&A activity* will exhibit *higher volatility* in tax expenses.	"That's a "classic" of low ETRs: you have a large tax-exempt capital gain in the book accounting, an absurd increase in profit, but taxes do not reflect that." (consultant)
Business model – Legal structure	*Permanent influence* on tax expenses, where *more subsidiaries* can be utilized for *more tax planning.*	"We have 60 to 70 big subsidiaries on five continents and each acts largely on its own." (tax manager)
Ownership	*Permanent influence* on tax expenses and on chosen *tax strategy.* Higher share of *involved owners* (e.g., family firms or large shareholder) leads to *more extreme outcomes* of tax planning.	"The large listed companies place great value to total ETRs including deferred taxes. Only people whose primary concern is the balance sheet instead of the cashflow statement will do that." (consultant) "The smaller a company and the closer it is connected to their owners, the more cash taxes come to the fore." (consultant) "[T]herefore, it is not unusual to have listed companies with the following reaction [to cash tax-saving schemes]: 'In that case, we can drop the idea outright, if it only saves us cash'." (consultant)
Financial position	*Changing influence* on tax expenses and especially limits the *availability of tax planning methods* (e.g., only use of excess liquidity). Also, it sets priorities and thereby	"Sometimes cash is king. Think of 2009 when a lot of companies, us as well, were in financial difficulties. In that case, liquidity is in focus." (tax manager) "If the company is less healthy and needs cash, deferred taxes will be sacrificed for cashflow effects." (tax manager)

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TABLE A1 – *Continued from previous page*

Characteristic	Nature of influence	Exemplary quotes
	aims of tax planning, as well as *appropriate KPIs*.	"Of course, multinationals also have possibilities [. . .] to use excess liquidity [. . .] in hybrid financing structures." (consultant)

Influence of Regulatory Context on Tax Planning

In order to render the second component of the availability of tax planning methods more comprehensible, we also provide evidence from our interviews on this aspect. TABLE A2 lists the limits and opportunities caused by regulation as viewed by our three interview groups.

TABLE A2
Regulatory context as a limit on, and opportunity for, tax planning

Group	Limit to tax planning	Opportunity of tax planning
Managers	"From a German perspective, it is not possible to achieve those extremely low ETRs of the past. This is due to deteriorated general conditions in two ways: tax authorities in crisis countries are extremely aggressive, and the German legislator is not friendly towards companies either."	"Other consequences are: England lowers the statutory tax rate to 20%, Switzerland adopts notional interest deduction and other nice tax gimmicks from Belgium."
	"Changes in tax rates constitute a single item in the tax rate reconciliation of our annual reports and, of course, we don't have any influence on our legislator, these effects are no tax planning."	"There are many countries offering R&D regimes and many companies use it. But also in those cases the question is if you really benefit from everything that's possibly out there on offer."

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TABLE A2 – *Continued from previous page*

Group	Limit to tax planning	Opportunity of tax planning
	"[Past developments of our ETR] can be explained to a large extent by the fact that we were simply lucky benefitors of the 2008 tax reform. [. . .] We benefitted from lower income tax rates, and measures such as thin cap rules did not apply to us."	"There are things like two-tier Malta structures, which we, for instance, chose not to do. This was because [. . .] by simply looking at it, it seemed wrong."
Consultants	"Employees in the tax department as well as external consultants are hardwired for ETR minimization – of course, within the legal frame."	"I can also influence [taxes] via transfer prices of the goods I produce."
	"When corporate income tax rates were lowered in Germany, this was suddenly a huge problem for some companies and ETRs surged. That sounds paradoxical but when you have tax losses [. . .] the higher the tax rate, the more valuable the tax loss. When statutory rates are cut, you see a huge effect and can hardly do anything against it."	"Germany invents thin capitalization rules, and thereby, non-deductible expenses increase. The ETR is down the drain, and instead of the 1% improvement of the ETR, which you promised the capital markets, you lose 2%. Then you have to do something else."
	"Stricter anti-abuse-rules or incentive-avoidance-rules make it not terribly attractive to engage in aggressive tax planning in Germany."	"What I have also already seen in connection with balance sheet management, is, that following the German Reorganization Tax Act you can exchange shares, divest, etc. neutral of tax—and due to missing congruency of financial and tax accounting, at fair value for the financial accounts."

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TABLE A2 – *Continued from previous page*

Group	Limit to tax planning	Opportunity of tax planning
Authorities	"It is never the case that we say something cannot be done due to tax reasons. But there may be tax consequences, that's just how it is."	"We had an interesting case in a country, where days counted, as this country was just about to make gains from sale of subsidiaries taxable. I dealt with several Heads of Taxes, who said [to their management]: 'If you ever want to sell this, then do it now!' These are situations where change is truly tax-driven."

Hurdle 2 – Desirable

Dimensions of Corporate Values and Their Influence on Tax Planning

As outlined in the main part, a further factor influencing tax planning via its original aims are the values that the company and its management follow. Our interviewees had different opinions on the strength and direction of this factor's influence on their selection of tax planning methods (see TABLE A3 below):

TABLE A3
Different impact of values on aims of tax planning

Approach	**Representative quotes**	**Impact on tax planning process and tax expense**
Moralist	"They [the owners] have a vision and want us to be known not only for sustainable products, but also to employ a sustainable tax strategy." "The social responsibility, which companies bear, is beyond dispute"	Exhibits strong motivation to abide by public opinion of which methods are considered morally acceptable, tax planning *less aggressive*.
Legalist	"Taxes are payments in the absence of consideration according to Paragraph 2 AO" [NB: AO is the German tax code] "As Tim Cook [CEO of Apple] said: That is the law, if you want to change it, please do so. But don't argue on the grounds of OECD arrangements wanting us to pay higher taxes voluntarily."	Refers back to the legal groundwork stating that no one should pay more taxes than he or she has to, tax planning *more aggressive*.

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TABLE A3 – *Continued from previous page*

Approach	**Representative quotes**	**Impact on tax planning process and tax expense**
Economist	"How do we behave in the interest of shareholders? Do reputational losses possibly outweigh saved taxes?"	Advocates that there is an optimum between tax saving benefits (i.e., less cash outflows) and tax saving costs (e.g., reputational cost), but agrees that the approach is rather theoretical, tax planning *more or less aggressive* depending on the firm's utility function.
Pragmatist	"If I believe that something could be advantageous tax-wise, then I make up my mind if others can support this. But not out of moral considerations, but out of company considerations."	Proclaims that there is often only little that the tax department can actually decide for itself, and that internal process considerations will, in most cases, already "kill" complex tax saving methods, tax planning *more or less aggressive* depending on the power of the Head of Taxes and the tax department to implement their tax saving methods.

Hurdle 3 – Implementable due to Tax Manager Power

In order to provide evidence for the four categories of tax manager power, we provide representative quotes from the interviews in TABLE A4.

TABLE A4
Representative quotes on sources of tax manager power

Category	**Representative quotes**
Internal formal power	"You can distinguish quite noticeably among the Germany largest companies where the tax department is positioned. Does it report directly to the C-suite or is it part of the accounting function?"
	"It's about the position of the tax department within the company, if they have any say among the finance function."
	"Even board members' salary—the CFO's, or CEO's—is often linked to profit before taxes. [...] What the investor cares about, namely increase in EPS, is funnily enough often not the case."
	"To me, a reasonable process features formal tax guidelines, which specify when the tax department needs to be consulted."
	"It is crucial for a Head of Taxes to assess to what extent tax planning is perceived as relevant and important. [...] In other words, is there a target agreement in the company for the management board, the supervisory board, the company in general which says: we want the lowest taxes possible."
Internal informal power	"In many companies, the tax department is perceived as a necessary evil. Thus, they learn last, what will be done."
	"If you tell a tax director 'do something to finally lower the ETR', he will respond 'how should I do this given that this idiot always says business, business, business?'."
	"To get the tax department onboard early in the process—that is something I have fought for a long time in the company."

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TABLE A4 – *Continued from previous page*

Category	**Representative quotes**
	"It was a process [to be involved more]. It originated from me being a member of the investment committee [. . .] which makes recommendations to the management board."
	"You can assure from a process point of view that the tax department is involved. I have to say that [. . .] in large companies it tends to work well, while small and medium enterprises tend to discuss informally on the corridors."
	"Concerning one topic, we regularly held meetings with other staff functions [. . .] because we noticed that we were working on similar topics and each of us only got fragmented pieces of information."
External reach	"Maybe we are an exception because I was a partner at KPMG, my colleague was a senior manager at EY and we have other colleagues from Big Four companies as well. That means, we are very well positioned with regard to the quality of our people."
	"If you work in the pharma industry, then you have to know that there are three phases during the approval of a new drug—if you do not understand the business properly, it will be difficult or even impossible to conduct effective tax planning."
	"I have seen and evaluated different [outsourcing practices of the tax function] during my time as a consultant and now among colleagues, since I am very well connected with other Heads of Taxes."
	"It is valuable—and this had nothing to do with morals—to have good relationships to the local tax authorities."
Capabilities	"You have to position yourself in a way that you are perceived as a department that understands the business, that sees its recommendation being accepted. That is, a department with a certain know-how."
	"There are tax planning structures, which we are very proud of where consultants say: 'Oh, that's something we have not yet seen. That is really clever.' That is something I really like to tell the management board about."

Appendix 3 – Case Studies

We develop five company case studies to illustrate our three-hurdle concept of tax planning and show its practical applicability.

Differences in Tax Planning Aims

Our hurdle 2 represents to what extent tax planning methods are regarded as desirable based on a company's tax planning aims. In order to make these differences more transparent, we provide evidence for our five case study companies in TABLE A5, which provides underlying quotes from the company representatives which explain "expected outcomes" as presented in TABLE 4.

TABLE A5
Exemplary Quotes for Tax Planning Aims of the Five Case Study Companies

Circle Corp.	**Balance Corp.**	**Star Corp.**	**Tile Corp.**	**Arrow Corp.**
”We always say that, first of all, we are an industrial company where the tax function is not of as great an importance as in a bank.”	“First, we have to be compliant. This aspect has gained increasing importance. Then, we have to use the leeway provided by the law. And, we have to support our colleagues in the business units.”	“Our goal has always been to avoid volatility, since we are not a tax planning company.”	“I think that each DAX 30 company Head of Taxes is—reasonable or not—evaluated by the ETR. That’s the main KPI.”	“The target is the target. If the board accepted [excuses], they could shut down the company. That applies to us as well as to anyone else.”
”We have KPIs for ourselves, but they are not steered from above. The board does not prescribe any KPIs.”	“In the company, the discussion [about potential tax structures] is mostly solved due to other reasons [than morals]. Just because the tax department is not the only party involved.”	“There is an area where we make use of existing benefits, that is, benefits explicitly provided by law. That sounds quite unspectacular, but it is an area where a lot of money can be saved.”	“We permanently watch the competition and their ETRs [...], and if they had ETRs of 40%, things would certainly be more relaxed.”	“It is not surprising that tax departments have grown to such a large extent and that our task is to keep tax burden as low as possible. That’s our job!”

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TABLE A5 – *Continued from previous page*

Circle Corp.	**Balance Corp.**	**Star Corp.**	**Tile Corp.**	**Arrow Corp.**
”There is a tax questionnaire which constitutes a comprehensive survey of all [tax] topics, very holistic.”	“You cannot hammer out a compromise through formal procedures. That’s something where people have to work together and come to a decision.”	“I don’t say that the ETR is total nonsense; it is simply irrelevant for us internally.”	”We often host beauty contests where we invite [. . .] the Big Four luminaries to tell us within three hours what the latest tax planning ideas are.”	“At the end of the day, there are three cost elements to be managed: costs of goods sold, administrative costs, and taxes.”

Measurement of Aggressiveness of Tax Planning Aims

Following these different tax planning aims, we construct a score intended to measure the varying degrees of aggressiveness in tax planning aims as expressed by the companies. TABLE A6 presents the underlying data and scoring scheme. We present the score for the values 1, 3 and 5, and leave out the intermediate values 2 and 4 for simplicity.

TABLE A6
Measurement of the score for aims of tax planning

Element	**Details and data used**	**Score values (1–5)**
Perception of tax department	*How is the work of the tax department perceived by the organization?* Score builds on interview statements; in some cases, from multiple interview partners commenting on the same organization.	*1:* Tax function is compliance and clearly a second priority, *3:* Tax department can add value, but must not deteriorate operating performance, *5:* Taxes are a cost to be managed like any other.
Objectives of tax department	*Which objectives does the tax department pursue?* Score builds on interview statements.	*1:* Provide stable forecasts with no concrete level of ETRs to be achieved, *3:* Keep volatility low and engage in proven tax planning methods which other companies already use, *5:* Optimize the global tax burden and implement latest trends of tax planning.
Evaluation of tax planning outcomes	*How does the tax department and the rest of the organization evaluate outcomes of tax planning (own and others')?* Score builds on interview statements; in some cases, from multiple interview partners commenting on the same organization.	*1:* Outcomes of tax planning cannot be influenced significantly, *3:* Results close to the home statutory tax rate are acceptable, *5:* Companies which do not optimize to the full extent exhibit lack of ambition.

Measurement of Tax Manager Power

We analyzed a total of 213 documents in addition to the interview data in order to establish an empirical measure of tax manager power. Furthermore, we also used company financial reports, as well as Worldscope and Amadeus data on peer companies in order to compare tax expenses to the peer group. TABLE A7 presents the underlying data and scoring scheme for tax manager power. In contrast to the score of tax planning aims, we split this score into sub-elements for each power category. Thus, on the sub-element level, we apply a mostly binary 1-0 scoring scheme if certain conditions are (not) fulfilled.

TABLE A7
Measurement of the score of tax manager power

Element	**Sub-element**	**Data used**	**Score values (0–1)**
Internal formal power	Post-tax KPIs tax department	Interviews	1: yes, 0: no
	Post-tax KPIs top management and business units	Interviews	1: both, 0.5: either one, 0: none
	High degree of formal guidelines for tax department involvement	Interviews	1: yes, 0.5: partially, 0: no
Internal informal power	Superior CFO access	Interviews and selectedly public information on CFO background	1: Access as needed and CFO tax-interested, 0.5: Access as needed or CFO tax-interested, 0: No access apart from Board meetings
	Staff function alliance	Interviews	1: yes, 0: no
	Enhanced operating business knowledge	Interviews and selectedly public information on Head of Taxes	1: yes, 0.5: partially 0: no

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TABLE A7– *Continued from previous page*

Element	Sub-element	Data used	Score values (0–1)
External reach	Representative in relevant associations	Press article search	1: Multiple and leading positions, 0.5: multiple positions, 0: only member positions
	Extensive work experience	Public information on Head of Taxes and interviews	1: yes, 0.5: partially, 0: none
	Independent use of consulting network	Interviews	1: yes, 0.5: with restrictions, 0: no
Capabilities	Publications	Literature review of publications by Head of Taxes	1: extensive, 0.5: some, 0: none
	University guest lecturer	Press article research	1: yes, 0: no
	Study background	Interviews and public information on Head of Taxes	1: Business and law, 0.5: Business or law, 0: other

We will provide more intuition for the choice of our proxies. Starting with internal formal and informal power, we chose to measure only the three most important ones which, first, were named repetitively during the interviews and, second, showed variation across our sample firms. The proxies of external reach are generally followed Finkelstein (1992)'s category of prestige power, with an adaptation of the measures to mid-level managers, such as the Head of Taxes. We chose association membership/leadership and work experience as appropriate proxies. Finally, our three sub-elements of capabilities grasp functional knowledge, as well as interpersonal skills, at the same time. Lecturers will likely exhibit high knowledge in their area of expertise, as well as superior oral communication skills. The (non-)existence of publications reveals the same for written communication and functional expertise. Last, study background captures the capabilities to bridge business and law perspectives in the case of double degrees.

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TABLE 1
Interview partners

Group	Details	Number of interviewees
Consultants and tax lawyers	Big Four audit firms	4
	Top-tier law firm	2
	Renowned German consultancies	3
Tax managers	Blue chips (DAX)	5
	Other German listed companies	3
Authorities	Tax audit department	2
Total		19

TABLE 2
Data sources and uses

Source	Type of data	Use in the analysis
Archival data	*Person-related information:* information (where possible) on education background, expertise, prior work, external activities.	Familiarize with interviewee background. Calibrate information gained during the interview. Construct tax manager power scores for case studies.
	Company-related information: Collection of 213 documents, including annual financial statements since 2000 (or latest available), website information published by investor relations, general company news, as well as tax related news, earnings call transcripts.	Familiarize with the company background to establish credibility for the interviews. Identify areas of investigation for follow-up in the interviews. Construct case studies.
Interviews	*Interview transcripts:* nine interviews in phase I (April–July, 2013) and 10 in phase II (September–November, 2013), resulting in almost 1,200 minutes of interview recordings, equivalent to 420 pages of single-spaced interview transcripts.	Conduct main analyses of contextual influencing factors on the tax planning process and its consequences for the tax expense of German multinational companies.
	Interview documents: In a few cases, interviewees handed out or sent documents after the interview or referred to specific publicly available information. This was mostly linked to their own organization in order to illustrate a point made during the interview or to peer companies in order to exemplify a different approach. Moreover, several suggestions for follow-up were made in relation to legal documents.	Follow up with hints for interpretation of interviews. Check credibility of what was said.

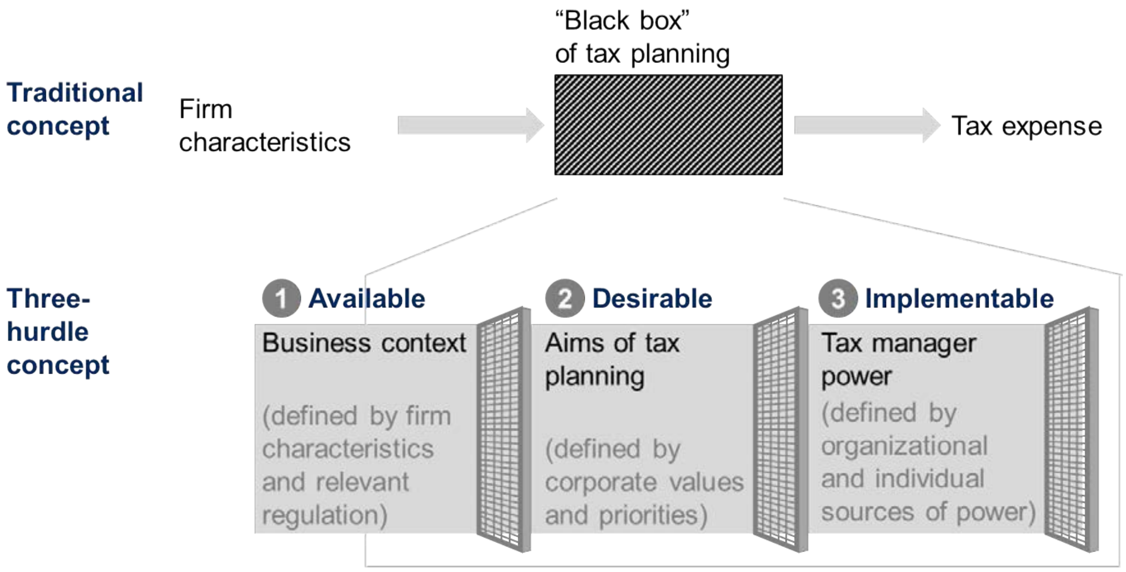


Figure 1 Three hurdles of corporate tax planning influencing tax expense

TABLE 3
Sources of tax manager power

Category	**Characteristics increasing tax manager power**
Internal formal power	*Higher organizational hierarchy level*, where tax department is situated, preferably directly reporting to a member of the C-level management team (e.g, CFO, CEO).
	Existence of *specific targets* for tax planning and linkage to *financial incentives.* Reflect overall importance of the tax function for the company, and incentivizes the Head of Taxes. In addition, higher extent to which *top management* and the *business units* are incentivized by *after-tax KPIs* equally matters.
	Sufficient resources of the tax function, that is, the *quantity and quality of the internal tax department*, and the available *budget for external tax consultants/lawyers.* While there is a substitution effect to some degree between the two types of resources, most interviewees deem it crucial to have at least *basic knowledge in-house* in all areas of tax planning.
	Higher degree of formal *mechanisms of authority* to influence/make decisions and give instructions for others to follow. Examples include directives, veto rights, and mandatory signatures.
Internal informal power	High-quality relations in three areas: First, access to *top management*, predominantly to gain support. Second, relations to the *business* to gather tax-relevant information quickly. Third, to other *staff functions* in order to foster alliances. For skills to maintain and create those relationships, see "capabilities" later on.

Continued on next page

TABLE 3 – *Continued from previous page*

Category	Characteristics increasing tax manager power
External reach	In addition to the internal relations, high-quality external relations in four areas: First, access to *tax consultants* to collect ideas and back up own solutions. Second, to the *tax authorities* to manage risks, for example during audits. Third, to *Heads of Taxes at other companies* in order to, again, gather best practices and enhance the credibility of own ideas. Finally, the capacity to deal with other *external stakeholders*, such as the press, or represent the company at public events also increases power or at least reflects the existence thereof.
	Moreover, increased visibility through *publications*, as well as *representative functions* in relevant industry and/or functional associations.
Capabilities	Higher level of *expert functional knowledge* in the area of tax planning due to education and/or experience from prior work. In this context, also a higher level of knowledge which is *unique and of relevance* to the specific company situation (e.g., related non-tax industry regulation, and how it can be exploited for tax planning).
	The existence of *social skills*, such as the ability to communicate clearly, negotiating skills, and pro-activity, serve as a facilitator to successfully interact with different stakeholders and to influence outcomes in one's favor.

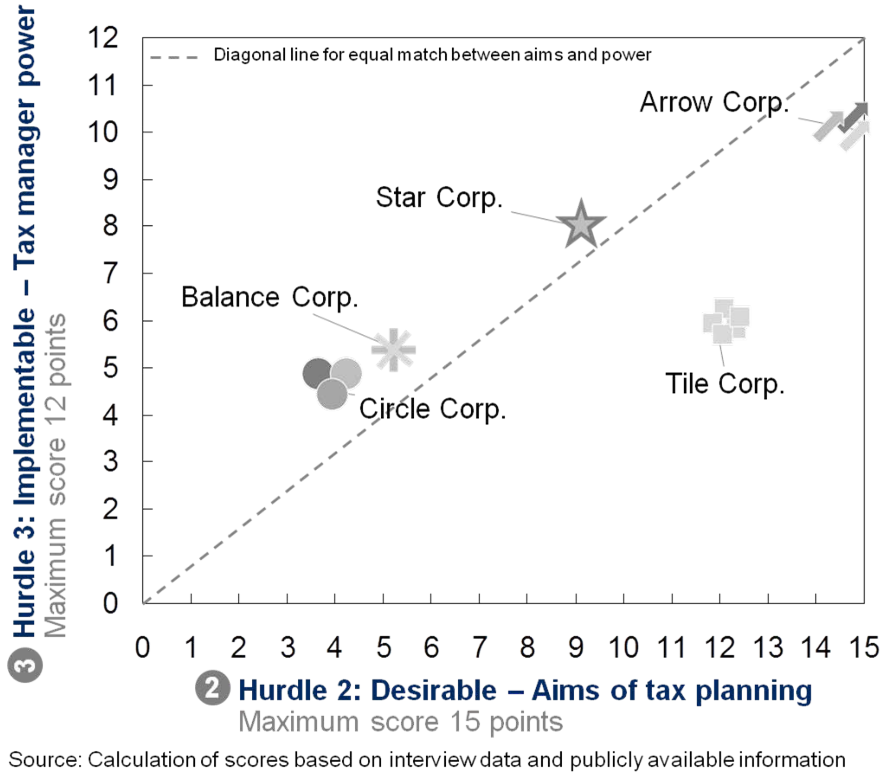
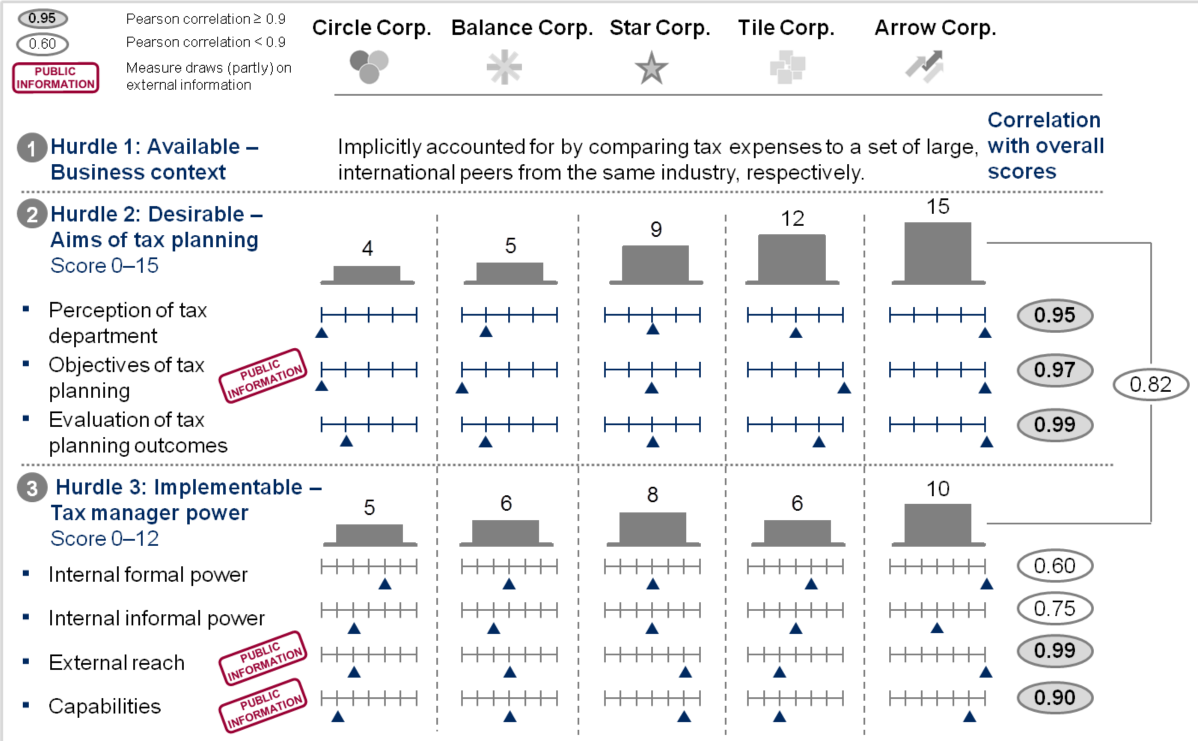


Figure 2 Correlation of aims of tax planning and tax manager power



Source: Collected data from publicly available information, interview insights, as well as Worldscope and Amadeus financials

Figure 3 Details on scores of aims of tax planning and tax manager power

TABLE 4
Comparison of expected and actual tax expense for the five case studies

		Evaluation of measures*						
	One-sentence tax	Tax expense pattern				Aims	Power	Match of actual
Case	planning strategy	Expected		Actual		score	score	vs. expected
Circle Corp.	Focus on compliance and “housekeeping work” across the globe.	Level	↑	Level	↑	↓	↓	Tax expense: ✓
		$Vola_y$	–	$Vola_y$	↑			Communication:
		$Vola_q$	↓	$Vola_q$	↓			none ✓
Balance Corp.	Support the business and treat taxes are no ends in themselves.	Level	↑	Level	↓	↓	↓	Tax expense: ✗
		$Vola_y$	–	$Vola_y$	↓			Communication:
		$Vola_q$	–	$Vola_q$	↓			very little ✓
Star Corp.	Use proven legal tax optimization for stable ETRs without abnormalities.	Level	→	Level	→	→	→	Tax expense: ✓
		$Vola_y$	↓	$Vola_y$	↓			Communication:
		$Vola_q$	–	$Vola_q$	→			selected ✓
Tile Corp.	Satisfy market expectations of peer-competitive GAAP ETR.	Level	→/↑	Level	↑	↑	→	Tax expense: ✓
		$Vola_y$	→/↑	$Vola_y$	↑			Communication:
		$Vola_q$	–	$Vola_q$	↑			abundant ✓
Arrow Corp.	Create value via tax planning, outperform peers.	Level	↓	Level	↓	↑	↑	Tax expense: ✓
		$Vola_y$	↓	$Vola_y$	↓			Communication:
		$Vola_q$	–	$Vola_q$	↓			abundant ✓

*We provide up to three expectations about tax expense: the average level of ETR (*Level*), the average annual volatility of the ETR ($Vola_y$), and the average volatility within the year based on quarterly ETRs ($Vola_q$). All measures are computed for 2004–2013 and evaluate the company’s position relative to peers: high (↑), average (→), and low (↓) ETRs and/or volatility. In general, ↓ is best as it represents low levels or volatility of tax expense. “–” indicates no expectation. Columns *Aims score* and *Power score* are a simplification of the scores of tax planning aims and tax manager power as calculated in Figure 2 on a high–medium–low scale (↑–→–↓). The final column reconciles expectations with both actual tax expense and how the firm communicates about it. The symbol ✓ indicates that expectations are met; ✗ expresses the opposite.

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