

Report on Bachelor / Master Thesis

Institute of Economic Studies, Faculty of Social Sciences, Charles University in Prague

Student:	Bc. Martin Stárek
Advisor:	Mgr. Petr Janský, M.Sc., Ph.D.
Title of the thesis:	The Scale of Corporate Profit Shifting out of the United States

OVERALL ASSESSMENT (provided in English, Czech, or Slovak):

Please provide your assessment of each of the following four categories, summary and suggested questions for the discussion. The minimum length of the report is 300 words.

Contribution

Multinational corporations optimize their overall tax burden by shifting profits between parent companies and their foreign affiliates. Martin Stárek analyzes determinants of profit shifting behaviour using a database of US multinational companies and their affiliates located in foreign countries.

It is necessary to understand the extent of profit shifting and its determinants. I consider the topic of the thesis important. This line of research can inform policy makers and can generate clear policy implications.

Martin Stárek builds on the existing research on profit shifting. The novelty of his thesis lies in a) incorporating a measure of financial secrecy among determinants for profit shifting, b) taking into account nonlinearity of relation between booked profits of foreign affiliates and average effective tax rate differences with respect to the U.S. and finally c) in adding time dummies that allow the influence of tax rate differences on booked gross income to vary over time.

One may be diverted to an easy and unfavorable conclusion that added value of this thesis is small – its contribution consists „only“ in „adding an index of financial secrecy, quadratic term of average effective tax rates, and interacted time dummies among regressors.“ That is all. However, such conclusion would be too simplistic and wrong. I appreciate that Martin Stárek combines literature on financial secrecy with the existing literature on profit shifting. This enables him to bring new evidence on the profit shifting behaviour.

Methods

My understanding is that Martin Stárek uses standard methodology used in this field of research (especially in the first step using gross profits as a dependent variable, average effective tax rate differences and other factors as independent variables). Mr. Stárek augments this regression by adding quadratic terms, interacted time dummies and some new independent variables (mainly the measure of financial secrecy).

Literature

Although I am not an expert on profit shifting, the literature used seems quite insufficient to me. It strikes me to see e.g. a reference to Janský (2016) IES working paper on page 3 as a reference to main ways how companies are shifting profits. Optimization of tax burden of international corporations is a long and well studied subject. There is also a huge transfer pricing literature that Martin Stárek seems to ignore.

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Manuscript form

On one hand the thesis seems very streamlined – the author works and presents his results in a very systematic way (step one, step two, step three etc.). On the other hand, I am not pleased how and where the author explains the variables used in his regressions. I would expect that each variable in the regression equation would be clearly defined in the section where the regression is described (e.g. chapter 6). It took me time to find out what the variables are and how they are defined. The text could be written much more clearly. E.g. I had to go to Acronyms to find out what the key regressor AETRD is.

The abstract is poorly translated to Czech. It reads like a word by word translation from English to Czech without much language instinct.

There are many many typos in the text, e.g. page 24: „revenue loses instead of revenue losses, lationship instead of relationship, etc. There are many typos in the Conclusion and there is a typo even in Abstract in Czech as if the author was in a hurry to finish his thesis. Although I do not want to cling to details by criticizing typos, it is not a good signal to the reader that the author paid an adequate attention to the thesis.

Chapter and sub-chapter numbering is confusing and wrong – e.g. page 24: 6.1 Step one, than page 25: 6.2 Step one, than page 26: 6.3 Step three or page 41: 8.3 Model with Financial Secrecy Index and than on page 44: 8.4 Model with Financial Secrecy Index again! I do not understand how come that the author did not correct such mistakes that make text more difficult to read.

Generally, the topic and used methodology is not a rocket-science. It is a mix of accounting and regression analysis. However, I feel that the author should have been better at explaining and describing what he was doing in his thesis.

Summary and suggested questions for the discussion during the defense

1. The author writes on page 50: „The Financial Secrecy Index proved to be economically significant, although its effect is statistically insignificant. This may be due to the lack of data since we have limited sample of both countries and years covered. However, the model with Financial Secrecy Index yields estimates that are by on average 35% higher than a comparable model without the Financial Secrecy Index, which is a large increase.“

Is it really meaningful to stress economic significance of the financial secrecy index in profit shifting if the index is statistically insignificant?

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2. In the thesis, I am missing an explanation and a description of an intricate tax relationships between parent companies and their foreign affiliates. E.g. loans with high interests provided between companies with the same owner have always been an instrument that corporations (regardless of being multinational or domestic) tried to use to optimize their tax burden. Tax authorities have taken several measures to limit such behaviour. Does the author know what measure(s) the tax authorities take?
3. The author writes on page 53: *„Our study suggests that the profit shifting problem appeared first at the turn of the millennium. Prior to that, the profit was shifted rather into the United States, however in relatively small amounts. After that, the amounts of shifted profit are estimated to increase almost exponentially (with some temporal drops), reaching maximum of almost 300 billion of U.S. dollars in 2015. In the same year, the estimates of revenue loss were the highest with the value of 62.3 billion of U.S. dollars. Opposite to that, a sharp decrease of both estimates is reported for the year 2009, when the shifted profit and the revenue loss dropped to almost zero. We can hypothesize that in a global financial crisis, profit shifting occurs less.“*

Why the profit shifting problem appeared first at the turn of the millennium? What may have triggered the change?

Overall, I find the thesis to be a decent piece of work, however, its potential remained untapped.

SUMMARY OF POINTS AWARDED (for details, see below):

CATEGORY	POINTS
Contribution (max. 30 points)	21
Methods (max. 30 points)	24
Literature (max. 20 points)	12
Manuscript Form (max. 20 points)	14
TOTAL POINTS (max. 100 points)	71
GRADE (A – B – C – D – E – F)	C


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NAME OF THE REFEREE: *PhDr. Pavel Vacek, Ph.D.*

DATE OF EVALUATION: *13 January 2019*



Referee Signature