

An effect of ownership structure on the capitalization of imputation tax credits into equity returns: A Pitch

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JEL:

1. Introduction

This pitching paper applies the template developed by Faff (2014) to an academic research topic in the finance discipline. In terms of my personal academic background, I am currently on my third year of the PhD program in Finance at La Trobe University, Victoria, Australia. My PhD thesis follows a three-working-paper structure. As a PhD candidate, I am definitively a novice to research. Along the learning curve of researching, finding a topic always seems to be the most difficult part and my earlier research topic was mostly suggested by my supervisor. Recently I start looking for another topic for my second working paper and I think that the pitching method should give me some helpful guidance in the process of identifying a worthwhile topic.

The idea for the pitch emanates from the knowledge that I accumulate from the first working paper of my PhD thesis. The area of this first working paper is about ex-dividend day pricing and trading. As the fundamental purpose of ex-dividend studies is to examine whether investor-level tax has any effect on equity pricing, reading this literature brings to me a broader view of tax research. Since my first paper focus on examining tax effect on equity pricing in a short event window of ex-dividend date, then I realise that how about we look at this tax effect in a longer horizon. This is where I came up with this pitch.

The remainder of the pitching paper is as followed. Section 2 outlines a brief commentary on my pitch. In Section 3, some personal reflections on the pitch exercise are given. Section 4 is a conclusion.

2. Brief Commentary on the Pitch

Table 1 presents the first version of the pitch. This pitch serves as a proposal of my very early idea on the new topic of my second working paper. The focused area of the pitch belongs to a connection between equity pricing and investor-level taxation in which the basic research question (B) is “Does a firm’ ownership structure has any effect on the capitalisation of imputation tax credits into equity returns?” The key papers (C) are Hanlon and Heitzman (2010), Lajbcygier and Wheatley (2012), and Siau et al (2013). The most critical paper among these three is Hanlon and Heitzman (2010) which provides a review of tax research literature as well as the remaining issues in the literature. The other two are identified as key papers since they are the only published papers that examine the relationship between imputation credits and equity returns in the long run. Even though they are not published in the Top-Tier journals of the Finance area or authored by “gurus”, the topic they investigate in their papers is unique to the Australian market. Furthermore, publishing on A* journals is still considered as high quality papers for the Australian studies alone. The motivation (D) of the proposed topic emanates from the literature of tax research and equity pricing. One of fundamental theoretical models in the literature hypothesizes and documents that marginal investors should play a key factor in determining the degree to which tax affects share price and returns. However, Australian studies on the capitalisation of imputation tax credits into equity prices seem to ignore this important factor. Thus, there is a need for incorporating and empirically testing the role of marginal investors in the capitalisation of imputation tax credits. “3-2-1” design of the pitching method which outlines the Idea, Data, Tools, What’s

New, So What, Contribution, and other Considerations is also explained throughout the remaining parts from (E) to (K).

3. Personal Reflections on the Pitch Exercise

The first and always the most difficult part for me and I believe for most of novice researchers in general is to find a new topic and identify whether this topic is worthwhile enough to start. One point from the pitching method that should be helpful for the process of looking for a worthwhile topic is to find foundation papers for your proposals and focus to the high quality papers only. It is understandable that the more you read the more you understand the literature and pitch a deal-breaker. However, reading the literature and especially top-tier journals is difficult and time-consuming especially for novice researchers compared to any others. Thus, it would be helpful if later versions of Faff (2014) can give an advice in terms of a reading scheme or reasonable timeframe as a guide for novice researchers.

Moreover, as Faff (2014) identifies that novice researchers often fall for the trap of targeting a missing country in the literature, this is the problem that I myself confront to. It is valuable to learn that a missing country is not a contribution unless there are special characteristics that make this country setting unique compared to others and predictions based on findings of other countries cannot be simply drawn to this country. This reminds me to clearly identify the difference in studied country setting in order to sell my research contributions.

Another thing I learn is the Mickey-Mouse approach. Since I got the idea for my second working paper before the pitching method was introduced to me, the Mickey-Mouse approach has not been applied to this topic. However, I realise that the idea of using Mickey-Mouse approach is brilliant and it definitely should be a part of my process in finding the third topic of my PhD thesis as well as future research.

Regarding to the part of other considerations, risks of insignificant results and competitor risks are the most serious challenges to me. I also think every researcher at some point of time will confront these risks. Thus, it would be helpful if later versions of Faff (2014) could give some advice to diminish the risks.

4. Conclusion

This letter presents a pitch for an empirical research proposal in the Finance discipline which will detect whether a firm's ownership structure has any effect on the capitalisation of imputation tax credits into equity returns. The current pitch is in its very first form and will be continued to be improved especially in terms of both Ideas and Tools. Following the pitching method in presenting my research proposal is definitively helpful. It not only keeps my research ideas organised and straightforward, but also helps improving my critical thinking and skills in the process of identifying a good research topic.

References

Faff, Robert W., Pitching Research (July 4, 2014). Available at SSRN: <http://ssrn.com/abstract=2462059>

Lajbcygier, P., and Wheatly, S.M. (2012), Imputation credits and equity returns, *The Economic Record* 88, 476-494.

Siau, K. W. S., Sault, S. J., & Warren, G. J. (2013). Are imputation credits capitalised into stock prices?. *Accounting & Finance*.

Pitcher's Name	Nguyen Ngoc Anh Le (First draft: 17 Oct 2014)
(A) Working Title	"An effect of ownership structure on the capitalization of imputation tax credits into equity returns: A Pitch
(B) Basic Research Question	Does a firm's ownership structure have any impact on the capitalization of imputation credits into equity returns and to what extent?
(C) Key paper(s)	Lajbcygier, P., and S.M. Wheatly, 2012, Imputation credits and equity returns, <i>The Economic Record</i> 88, 476-494. Siau, KW. et al, 2013, Are imputation credits capitalised into stock prices?, <i>Accounting and Finance</i> , 1-37
(D) Motivation/Puzzle	Although the hypothesized negative relationship between imputation tax credits and equity returns has been recognised, it has been closely examined only recently by Lajbcygier and Wheatly (2012) and Siau et al (2013). However, no evidence that imputation credits are capitalised into equity returns is found. Both papers thus implicitly assume that the Australian market is integrated or say another way the marginal investor setting equity prices in the Australian market is assumed to be non-resident. However, while the role of marginal investors is addressed in the literature, apparently it seems to be ignored in these Australian studies. According to Bell and Jenkinson (2002), in practice marginal investor may differ across companies. Li (2007) also suggests that the level of institutional ownership for specific firms may present marginal investor tax status. Thus, integrating a firm's ownership structure is likely to deepen the understanding of the capitalization of imputation tax credits into equity returns.
THREE	Three core aspects of any empirical research project i.e. the " IDioTs " guide
(E) Idea?	The core idea is to introduce a firm's ownership structure to the Australian existing literature on the capitalization of imputation credits into equity returns. In particular, does the level of domestic ownership have any effect on the relationship between imputation credits and long-term equity returns? Moreover, among firms with high level of domestic ownership, how does the capitalisation of imputation credits into equity returns vary according to the level of domestic institutional and corporate ownership?
(F) Data?	CHESS ownership data is recently relieved for research purposes through SIRCA. CHESS data consists daily holdings aggregated into various type of investors for stocks trading on the ASX, providing a more complete dataset for firm ownership information.
(G) Tools?	A regression model approach. Stata software
TWO	Two key questions
(H) What's New?	The novelty of the paper is to enrich the very early literature on the investigation whether imputation credits are capitalised into equity returns. Whether or not imputation credits are capitalised into equity returns should depend on the identity of the marginal investors which are aimed to be proxied through the ownership structure.
(I) So What?	The answer to the research question has important implications on other fundamental issues such as cost of equity capital, required rate of returns and asset pricing. Moreover, understanding on the capitalisation of imputation credits has significant meaning to investors in making investing decisions. Australian setting
ONE	One bottom line
(J) Contribution?	The contribution is to link a firm's ownership structure to the relationship between imputation credits and equity returns.
(K) Other Considerations	Risk of insignificant results: The underlying assumption of the study is that marginal investors can be identified and proxied through ownership structure. However, there is a risk that this assumption is not holding. Data Risk: CHESS data often takes around three months to be completely retrieved.