Managers, Multinationals, and the Design of Corporate Taxes*

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Jose Fillat
Federal Reserve Bank of Boston

Stefania Garetto
Boston University, CEPR and NBER

Cole Kurokawa
Federal Reserve Bank of Boston

1 Motivation

Corporate tax revenue in advanced economies is collected disproportionately from a small number of firms that are simultaneously large, multinational, and led by highly compensated executives. Policy discussions often treat these three characteristics as interchangeable markers of the same population of "big firms," so that proposals to tax large corporations, to tax multinational profits, and to tax high executive pay are presented as near substitutes. We argue that this equivalence is misleading. Firm size, multinational status, and managerial talent are jointly and endogenously determined, and instruments that fall on the same firms operate through different selection margins. As a result they raise different amounts of revenue, distort different decisions, and impose different efficiency costs per dollar collected.

2 Framework

We build on the dynamic model of firm-manager matching and multinational expansion in Fillat and Garetto (2026). Heterogeneous firms hire managers of heterogeneous ability through a competitive search process with coordination frictions à la Shimer (2005). In addition, firms have to decide whether to operate only in their domestic market or also abroad, thus becoming multinationals. Each firm chooses its multinational status and its manager to maximize the expected present discounted value of its profit flows, which depends on the firm productivity and on the ability of the manager it hires. Selection into multinationality is modeled through a dynamic trade-off between fixed and variable costs, similar to Helpman et al. (2004) and Fillat et al. (2015). This trade-off is further modulated by managerial ability, which lowers the fixed costs of foreign operations and raises the fixed costs of domestic operations. As a result, firms that hire higher-ability managers are more likely to expand abroad. Because better managers match on average with more productive firms, in equilibrium there is a positive correlation between firm productivity, firm size, multinational status, managerial ability, and managerial compensation. However, since the match between firms and managers is imperfectly assortative, policy interventions like taxes or subsidies have the effect of reallocating talent across firms, and of reallocating firms' activity across markets.

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The endogenous determination of the firm-manager match and of the multinational status of the firm is our point of departure from analyses that treat firm size as a sufficient statistic for a firm's exposure to business taxation. In our framework, a tax that scales with firm size, a tax on the foreign profits of multinationals, and a tax on the profits of firms with high executive compensation operate through three distinct selection margins, even when calibrated to raise the same revenue.

3 Three Tax Experiments

We calibrate the model to match aggregate moments related to multinational activity and to the managers' labor market. We then use it as a laboratory to compare three tax instruments.

1. **A size-based tax**, such as a surcharge on firms above a revenue or asset threshold. It operates through the productivity margin and does not directly affect either the decision to invest abroad or the matching of managers to firms.
2. **A tax on the foreign profits of multinationals**. It discourages foreign direct investment (FDI) directly and, in equilibrium, tightens selection into multinational status around the most productive firms.
3. **A tax on the profits of firms with high executive compensation**. It operates through the market for managerial talent, because firms can partially avoid it by hiring lower-paid and/or lower-ability managers, at the cost of a smaller option value of foreign expansion.

We implement two normalizations. The first sets rates so that the direct effects on aggregate firm value coincide when multinational status and manager assignments are held at baseline. The second, which is the standard benchmark for comparing tax instruments, sets rates so that the three taxes raise equal revenue in equilibrium. The two normalizations do not coincide, and the wedge between them is itself informative: an instrument that firms avoid by substituting toward cheaper managers has different implications for the revenue per dollar of firm value destroyed than one they can avoid only by ceasing to operate abroad. For each experiment, we decompose the total effect into three parts: the direct effect, the effect of allowing multinational status to adjust, and the effect of allowing the matching market to re-clear.

4 Outcome Variables

Because the three instruments reach a similar population of firms but distort different decisions, the comparison requires outcomes that capture real adjustment rather than reported profits alone. For each experiment we report the following.

Revenue and the elasticity of the tax base. We compute equilibrium revenue for each instrument and trace it against the statutory rate. The three bases erode through different channels, and only for the foreign profits tax is base erosion a sufficient statistic for the reduction in real foreign activity. Under a tax on executive pay a firm can leave the base while continuing to operate abroad, simply by hiring a cheaper manager, so revenue and real activity are linked only indirectly through the effect of managerial ability on fixed costs. We expect the revenue-maximizing rate to differ across the three instruments for this reason.

Real foreign activity. We measure the extensive margin as the share of firms operating abroad, together with the productivity distribution of the firms that continue to do so. This records where production takes place rather than where income is reported, which distinguishes our exercise from the literature on profit shifting (Tørsløv et al., 2023).

The allocation of managerial talent and its output cost. Each tax reallocates managers across firms. Because ability lowers fixed costs abroad and raises them at home, a reallocation of managers toward domestic firms moves talent to where its marginal product is lower. We quantify the resulting loss in aggregate output, which converts the reallocation from a descriptive finding into a measure of efficiency cost.

Compensation dispersion. We report dispersion in executive pay across firms, summarized by the multinational and the ability compensation premia. Once non-managerial labor is added to the model, as described in the second additional experiment, we also report dispersion within firms.

Incidence shares. We decompose the burden of each tax into the portion borne by managers, through compensation and downward quality substitution; by owners, through firm value; and by the wider economy, through foregone foreign investment. Reporting these as shares of the total makes our results comparable to the incidence literature (Suárez Serrato and Zidar, 2016), in which the split between owners and workers is the central object.

Efficiency cost per dollar of revenue. Combining the previous items, we compute the output loss per dollar raised under each instrument. This is the statistic that determines whether the instruments are substitutes in any meaningful sense.

5 Predicted Effects

The model's mechanics generate sharp predictions about how the three instruments differ.[1] Each tax operates through a distinct adjustment margin, and the strength of that margin determines how much of the tax burden is absorbed through reduced multinational activity versus reallocation of managerial talent.

A tax on foreign profits directly affects the value of foreign direct investment and the firm's option to expand abroad. Because it offers firms no avoidance margin other than exiting multinational status, we expect it to generate the largest contraction in the multinational share of firms, concentrating surviving multinational activity among the most productive firms.

A tax on firms with high executive compensation operates through the market for managerial talent rather than directly through the FDI margin. Firms can partially avoid it by hiring lower-ability, lower-paid managers, which dampens the contraction in multinational activity relative to the foreign-profits tax but does so by disproportionately discouraging expansion among firms with the best managers, precisely the firms for which FDI is most valuable.

A size-based tax does not interact directly with either the FDI option value or the manager labor market. We expect its effects on multinational selection and managerial reallocation to be more muted than either of the above, since it does not specifically penalize the returns to becoming multinational or the returns to hiring talented managers, even though it may raise comparable revenue from a similar set of large firms. Differences in the welfare changes induced by these measures will be evaluated quantitatively in the calibrated economy.

[1] For this paper, we plan on a calibration fully centered around real variables, different from Fillat and Garetto (2026). This calibration is still in progress.

6 Additional Experiments

Three further exercises are natural in this framework and connect our results to existing empirical estimates.

Entry elasticities and effective tax rates. Devereux and Griffith (1998) established that discrete location decisions respond to the effective average tax rate while the scale of foreign operations responds to the effective marginal rate. Our model contains both margins, since entry is governed by a fixed cost threshold and scale by variable profits. We compute the semi-elasticity of multinational entry with respect to the effective average rate on foreign earnings and the corresponding scale elasticity, which allows us to benchmark the model against estimates in the location literature rather than presenting the counterfactuals as standalone calibration results.

The design of a tax on executive pay. The legislative proposals do not take the form we implement. They specify a graduated surcharge on the corporate rate that rises with the ratio of chief executive to median worker compensation (U.S. Congress, 2025). Two features matter. A graduated schedule creates incentives to locate just below each bracket, which our framework can capture directly. More importantly, the ratio has a denominator, so firms can reduce their liability by raising median worker pay or by shedding low-wage workers. Adding non-managerial labor to the model introduces this second avoidance margin and lets us ask whether a tax intended to compress pay dispersion achieves that outcome or instead changes the composition of the workforce.

Anticipated reforms. Because foreign entry is a real option, the timing of a tax change matters separately from its level. An announced future increase in the tax on foreign profits should accelerate entry before the effective date, while an announced reduction should delay it. Recent legislation has featured announced effective dates and phase-ins, and a static framework cannot generate these dynamics.

7 Contribution

Our contribution to the analysis of business taxation is to show that instrument design matters independently of the tax incidence on aggregate profits, because different instruments load on different selection margins, and those margins are determined jointly in equilibrium. Our exercise is designed such that the taxes raise comparable revenue, yet they deliver very different aggregate contractions due to the responses of the foreign direct investment margin and of the manager hiring margin, and therefore different efficiency costs per dollar collected.

These results speak to current proposals to tax large corporations, foreign profits, and executive compensation, which are frequently discussed as near substitutes. Our analysis suggests that they are not. A tax on executive pay is, in this framework, a tax on corporate profits whose incidence is divided among managers, through compensation and downward quality substitution; owners, through firm value; and the wider economy, through foregone foreign investment. The matching market determines the division, and a framework with frictionless assignment of managers to firms would attribute none of it to managers.

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