The Effects of Increased Book-Tax Difference Tax Return Disclosures on Firm Valuation and Behavior

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ABSTRACT

We use event study techniques to gauge market participants’ ex ante perceptions regarding the benefits and burdens of the Schedule M-3, and structural break analysis to investigate whether managers make ex ante or ex post changes in book-tax differences as a result of this mandatory change in federal tax return disclosures. We find evidence suggesting investors believe ex ante the substantial increase in book-tax difference disclosures will increase future tax burdens and/or tax-compliance costs. Investors also appear to believe the M-3 may be more costly for firms having the types of book-tax differences that attract additional IRS scrutiny (e.g., discretionary permanent differences) and when such firms are weakly monitored. Further, we find evidence of a substantial reduction in our proxy for discretionary permanent book-tax differences prior and subsequent to the implementation of the M-3 and other regulatory events, suggesting both ex ante and ex post real effects on firm behavior.

JEL Classifications: G14; H25; H26; M48.

Data Availability: Data used in this study are available from public sources identified in the paper.

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Copyright © 2018. Tax Policy Center. Book-tax differences represent different amounts of commercial profit based on financial reporting standards with fiscal net profit obtained in tax regulations (Hanlon, 2005). Management of company prepares financial statements, in each accounting period with two different objectives, to fulfill the obligation to make financial reporting by International Financial Reporting Standards (IFRS) and to fulfill the tax obligations. This study will examine the effect of book-tax differences on the price book value of manufacturing companies listed in the Indonesian Stock Exchange as the national capital market authority. Companies listed in the Indonesian Stock Exchange are called emiten. Identify book-tax differences that increase taxable income and explain how to reconcile retained earnings on Schedule M-2. Ms. Hennig has published numerous tax articles in many major tax journals, is an author or co-author of numerous tax texts, including Practical Guide to Schedule M-3 Compliance (Second Edition) and Contemporary Tax Practice: Research, Planning and Strategies (Second Edition), both published by CCH. She has written and taught numerous continuing professional education courses. She was a faculty intern with local and national CPA firms, and conducted research for the IRS Statistics of Income Division and the District Office of Research and Analysis.