How does management respond to tax risk?
Evidence from the M&A setting

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February 2026

Abstract

Utilizing the M&A setting, I investigate whether and how a target firm's tax risk impacts the acquirer's decision-making. Using the ex-ante tax risk measure from Neuman et al. (2020), my overall findings suggest target firm tax risk is associated with increased effort in due diligence, but that these efforts do not appear to fully mitigate future adverse financial reporting consequences. I first examine the likelihood of withdrawal and find that operational tax risks are associated with an increased likelihood of withdrawal, concentrated in target firms with high organizational complexity. Next, I find that target firm tax risk is positively associated with longer due diligence periods and higher advisory fees paid, which is consistent with tax risk increasing due diligence efforts. This increased effort appears to be driven by target firm managerial tax risks, which arise when the target firm's personnel lack sufficient tax knowledge or resources. Finally, I examine financial reporting consequences in the post-acquisition period and find that the likelihood of both tax-related misstatements and non-tax misstatements increases with target firm tax risk, driven by managerial risk. In cross-sectional analysis I find that the increase in tax-related misstatements is concentrated in deals that experienced overall workforce reductions after the acquisition and where the target firm has greater organizational complexity. My study provides evidence that acquirers recognize and respond to target firm tax risks, but that the response is not sufficient to mitigate future misstatements. My findings also suggest that a key source of tax risk in M&A stems from personnel knowledge suggesting post-merger integration issues. The evidence in this study is consistent with assertions that tax risk is meaningful in management decisions and drives real outcomes in the M&A setting.

1. Introduction

While no singular definition of tax risk is yet agreed upon, broadly, tax risk can be considered in terms of the risks inherent in a given tax strategy, or risks associated with proper execution of the tax strategy (Donohoe, McGill, and Outslay 2014). Recent research describes the construct as multifaceted, driven by an array of firm attributes and varying across operations and geographies (Brühne and Schanz 2022; Neuman, Omer, and Schmidt 2020). Managing tax risk has become an increasingly important topic for tax practitioners (Donohoe et al. 2014; Brühne and Schanz 2022; EY Americas 2023), but the academic literature provides a limited understanding of the importance of tax risk in management decision-making. In this study, I investigate the impact of tax risk on management decision-making utilizing the mergers and acquisitions (M&A) setting.

There are several factors that make the M&A setting appropriate for this analysis. First, the acquisition of a company is a major investment involving careful planning and due diligence. When purchasing the entirety of an existing company, the risks of that target firm are absorbed by the acquirer, particularly for publicly traded firms. This increases the likelihood that tax risks may have a measurable effect on negotiations and the combined firm's outcomes. The private nature of tax information decreases the likelihood that the acquirer observes the scope of tax risks prior to entering into negotiations with a target firm. Further, disclosure requirements for publicly traded firms provide information on the due diligence period, providing insights into the decision-making process unobservable in many other types of investments.

Second, in the M&A setting, management of the acquirer should be concerned not merely with outcomes of a target firm's prior positions, but also with the target firm's *ex-ante* tax risks which may impact the combined firm's future tax outcomes. Because a firm's tax risk includes

not only risks related to current and prior tax strategies but also risks in the execution of the strategies, analyzing the multiple facets requires a sufficiently broad measure. The *ex-ante* tax risk measure from Neuman et al. (2020) is comprised of six categories of firm characteristics following a tax risk management best practices framework and "represents the tax risk generated by all business activities" (p.1791). This measure is ideal in this setting to capture the impact of target firm tax risk on management decision-making.

Tax has been shown to influence aspects of M&A including overall activity (Blouin et al. 2021), pricing (Klassen and Mescall 2018; Chow et al. 2016; Hanlon et al. 2021; Ayers et al. 2003), transaction structure (Erickson and Wang 2000; Erickson and Wang 2007; Ayers et al. 2004; Hanlon et al. 2021) and deal outcomes (Huiziniga and Voget 2009; Blouin et al. 2021; Edwards et al. 2016; Devos et al. 2009). In their review of the literature, Hanlon and Heitzman (2010) note a lack of understanding how target firm tax risk impacts the negotiation process. While M&A negotiations are private and difficult to measure directly, their substance is informed by the due diligence process (Thomson Reuters 2024). My study explores the impact of tax risk on the due diligence process and on M&A outcomes. Results of the study increase our understanding not only of the consequences of target firm tax risk in the M&A setting but also shed light on the facets of tax risk that are associated with negotiation and financial reporting outcomes.

In M&A transactions, firms must undertake due diligence to uncover risks and verify the financial and operational representations made by the target firm's management. Tax due diligence is an increasingly important aspect of overall due diligence (Thomson Reuters 2024). However, tax information of a firm is typically private. As described by Wangerin (2019), the target usually does not provide private information to the potential acquirer until a confidentiality

agreement has been signed. Further, the author describes that typically the most extensive private information is shared only after the acquisition agreement has been signed. A target firm may have high tax risk arising from a variety of sources. Risks such as the existence of aggressive tax positions may be assessed through a review of the target firm's financial statements, though other important risks such as poor internal documentation, or low knowledge or ability of tax personnel to properly execute tax strategies, are not easily assessed without the target firm's private information. The goal of the acquirer in due diligence is to understand and effectively respond to all of these risks to ensure a smooth transaction.

Tax risks uncovered during due diligence can impact the negotiation process, and in some cases can even lead the parties to walk away from the deal (EY Global 2019; Roedl & Partner 2022). Thus, the first aspect of the M&A setting that I examine is the impact of target firms' tax risk on the likelihood of deal withdrawal. Tax risk has also been associated with higher financial and organizational complexity (Balakrishnan et al. 2019) which could increase the effort required to ensure proper assessment of a target firm's structure and positions, leading to higher advisory fees and more time spent in review and negotiations. To study if tax risk leads to increased managerial effort, I examine whether tax risk is associated with longer than average due diligence and higher advisory fees. I hand-collect confidentiality agreement dates disclosed in acquisition agreements and construct due diligence periods following Wangerin (2019). Because of the private nature of tax positions and filings, I expect that the largest effect, if any, will be on the final, transactional due diligence period in which the majority of private information is expected to be shared by the target firm. As an alternative test of managerial effort, I also examine the impact of tax risk on the extent of advisory fees incurred during the M&A

transaction. These tests should provide evidence about the impact of target firm tax risk on the due diligence and negotiation process.

In my last set of analyses, I examine the consequences of tax risk on post M&A outcomes, specifically the likelihood of financial misstatements within the next three years. A target firm's tax risk may be tied to many aspects of business, from operating structure to financial account estimations. Although certain historical tax attributes of the target firm's assets may be eliminated in the M&A transaction, tax risks associated with the target firm's global structure, ongoing agreements, or tax knowledge retained by employees may persist post-acquisition. Longer due diligence, while costly, can facilitate adequate planning and structuring of the deal to minimize negative consequences for the continuing company.

A lack of adequate due diligence increases the risk that important tax information of the target firm is not well understood by the acquirer. In a recent global survey conducted by EY, over half of the senior tax leaders responding indicate that their firms rarely, if ever, involve their tax function personnel in corporate restructuring or M&A transactions (EY Americas 2023). This lack of communication could increase the chance that adverse financial consequences can occur in future years and may exacerbate complexities of integrating the target with the acquirer. In line with this, I consider whether tax risk in the target firm, low due diligence effort, or both increase the likelihood of a financial misstatement by the acquirer in the years immediately following the M&A transaction. I utilize the restatement database from Audit Analytics and examine the likelihood of tax and non-tax related misstatements during the three years after the M&A transaction.

My sample of M&A transactions, obtained from the SDC database, includes deals announced between 2002-2020. I require both the acquirer and target to be U.S. public

companies, which helps to ensure that there are both sufficient data availability for measures and that each target company is subject to the jurisdiction of US tax authorities, which allows for more comparability across firms. Further, I require that the acquiring firm owns under 50 percent of the target firm before the deal announcement and seeks to own 100 percent of the firm. Only deals with the status "Completed" or "Withdrawn" are retained. These transactions are merged with acquirer and target firm variables to construct each sample dataset.

I replicate the ex-ante tax risk measure of Neuman et al. (2020), aggregating variables across the six components of transaction risk, operating risk, financial accounting risk, compliance risk, managerial risk, and reputation risk, and extend the time frame covered.[1] A comparison of my measure to theirs shows a correlation coefficient of 0.83 (untabulated). To understand both the salience of overall tax risk and the components that drive it, I test my hypotheses using both the aggregated *TAXRISK* measure, as well as the six disaggregated tax risk components.

Results of my first hypothesis suggest that overall tax risk isn't significantly associated with an increased likelihood of deal withdrawal. However, I do find a significant relationship for firms with high organizational complexity (significant at the 5 percent level). This result suggests that, for complex targets, a one unit increase in *TAXRISK* leads to a four-fold increase in the likelihood of withdrawal. These results are consistent with tax information being of lower order importance in major business decisions, but that tax risk becomes more salient as complexity increases. Analysis of the risk components reveals that this relationship is driven by the target firm's tax operating risk, a measure which considers the extent of a firm's tax havens, foreign operations, sales volatility, and offshore intellectual property. In this context, tax operating risk

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[1] The data on Fortune 500 Most Admired Companies used by Neuman et al. (2020) is no longer publicly available. Thus, to calculate reputational risk I used the ranking of the top 50 most admired companies.

describes applying existing tax laws to daily operations (Neuman et al. 2020). Thus, it follows that as organizational complexity increases, tax operating risk becomes an important factor in the decision to pursue an M&A transaction. This finding complements results in Chow et al. (2016) and Mescall and Klassen (2018), who find, respectively, that tax shelter participation and transfer pricing risk, are associated with lower acquisition premiums. My results suggest that these risks, when severe, may also contribute to the decision to withdraw from a deal.

My second set of analyses examines the influence of tax risk on several measures of managerial effort in due diligence. I first examine the due diligence review (DDR) period, which extends from the date of signing the confidentiality agreement to the date of signing the acquisition agreement (Wangerin 2019). I next examine the transactional due diligence (TDD) period, which extends from the acquisition agreement date to the deal close date. I find that overall target firm tax risk does not impact the length of the DDR period, but I do find some evidence that it increases the length of the TDD period (significant at the 10 percent level, one tailed), which is consistent with private tax information being shared later in the due diligence process. Further, I find strong evidence that the fees paid to outside advisors increase significantly with target firm tax risk (results significant at 1 the percent level, one tailed). Results of examining the tax risk components show that both the increased length of TDD and increased advisory fees appear to be driven by managerial risks. Managerial risk reflects the adequacy of the tax department's resources and technical skills necessary to appropriately manage tax risks (Neuman et al. 2020). High managerial risk may reflect lower skills or lower resources in the target firm's tax department, and may also be indicative of an increased likelihood of hidden tax liabilities or lower quality documentation, which requires increased

effort to assess the target's tax positions. Overall, I find evidence that tax managerial risk in the target firm appears to increase due diligence effort in M&A transactions.

My final set of analyses examine consequences of target firm tax risk. Specifically, I examine the likelihood of financial reporting misstatements by the combined firm in the three fiscal years following the M&A transaction. My results show that high tax risk in the target firm is associated with a significantly higher likelihood (1 percent, one-tailed) of both tax-related misstatements as well as non-tax misstatements. Analysis of the risk components indicates that the increased likelihood of tax-related misstatements is driven by the target firm's managerial risk. This complements my earlier finding that managerial risks in the target firm are associated with increased acquirer effort and demonstrates real consequences of these personnel-related risks to the acquiring firm.

In cross-sectional analysis, I find that this increased likelihood of future misstatements is concentrated in the firms that have an overall employment reduction following the M&A transaction, calculated as the difference between the total employees of the target and acquirer pre-acquisition and the employees of the combined firm in the post-acquisition period. This finding is consistent with poor knowledge transfer in the integration of the target firm to the acquirer. Further, I find that these results are again concentrated in firms with high organizational complexity. Interestingly, I find that the result is also concentrated in firms with high M&A advisory fees, suggesting that increased effort in due diligence is insufficient to mitigate future tax-related misstatements for the combined firm.

Together, the results of my analysis show that management appears to recognize and respond to tax-related risks in the M&A setting, but their response may not be sufficient to prevent future adverse financial reporting consequences. Apparent risks, like those associated

with the target firm's global tax structure, increase the likelihood that a deal will be cancelled. However, tax risks surrounding target firm personnel and knowledge transfer appear to increase due diligence length and advisory fees, as well as the likelihood of tax-related misstatements in the post-acquisition period. Taken together, this study provides evidence that ex-ante tax risk influences management's decision-making, but that not all tax risks, particularly those surrounding personnel, are managed sufficiently.

Because ex-ante tax risk is broad in both concept and measurement, an important limitation to recognize is the potential for correlated omitted variables. While I attempt to mitigate this through my sample construction and the use of extensive controls, it must be acknowledged that other factors could be driving the results. Additionally, as is common in archival studies, I must acknowledge that causality cannot be inferred through these tests. However, the results from the components analysis are consistent with areas of tax risk found in prior literature to be important in tax risk mitigation. First, my results are consistent with management responding to risks in a target firm's organizational complexity, particularly around foreign activities, adding to the findings from Mescall and Klassen (2018) who demonstrate that management responds to transfer pricing risk through reducing acquisition premiums. Second, my results suggest that tax personnel knowledge and communication are important risk mitigation tools, which is consistent with the results of the survey of tax practitioners from Brühne and Schanz (2022). Third, my findings are consistent with research which demonstrates that having sufficient corporate tax personnel is associated with lower tax risk (Chen et al. 2021).

This study contributes to the literature on the consequences of tax risk by demonstrating that target firm tax risks are associated with increased likelihood of deal withdrawal, increased due diligence effort, and increased likelihood of financial misstatements in future years. These

findings support the view that tax risks are multifaceted and that each facet has potential to impact decisions and outcomes differently. My results add to the growing understanding of how tax risk can impact management decision-making and financial reporting outcomes.

These results also contribute to literature on the role of tax in the M&A setting. Across a series of tests, I show that tax risks impact management decisions and effort during due diligence. I also show that tax risks can lead to adverse financial reporting consequences for the combined firm in future years. This enhances our understanding of the role of tax in M&A negotiations and outcomes and furthers our understanding of how tax risks can impact management's investment decisions. My results complement existing literature on the impact of tax on the M&A setting and shed light on sources of tax risk that haven't been extensively studied in the M&A literature.

Lastly, this study operationalizes a relatively new measure of ex-ante tax risk. Using a setting where ex-ante risks are highly relevant for management decision-making, I find that this measure captures aspects of a firm's risk profile that are meaningful and relatively unexplored. My results suggest that the measure provides important ex-ante information that is useful for assessing tax-related risks.

2. Background

Over the last three decades, globalization has increasingly subjected firms to new jurisdictions' tax law and tax authority oversight. While this has increased exposure to risks, it has also provided firms with new or enhanced avenues for tax planning. These changes coupled with rapidly evolving global tax regulations have increased the importance of tax planning and tax risk management for corporations (Donohoe et al. 2014). KPMG describe the purpose of tax risk management is to "avoid unnecessary tax costs, whilst ensuring sound compliance with

legislative requirements" (KPMG 2025). While tax costs clearly encompass tax liabilities and assessments from tax authorities, management must also consider costs of compliance, personnel costs, and the costs of missed tax planning opportunities. In their 2023 survey of executives on tax risk and controversy, EY found that executives are increasingly focused on tax risk management, but more than half of the respondents indicate their tax function is not heavily involved in restructuring or M&A activities of the firm, which indicates potential exposure to tax-related consequences from these transactions (EY Americas 2023).

2.1 Prior Literature on Tax Risk

Academic literature has increasingly focused on the role of tax risk in a firm's tax planning function, but a concise and agreed upon definition of the construct is still being developed. While the terms tax avoidance, tax aggressiveness, and tax uncertainty are more prevalent in literature, they are thought to be related to tax risk (Blouin 2014; Dyreng et al. 2019; Brühne and Schanz 2022). Brühne and Schanz (2022) find wide ranging definitions of tax risk used across prior literature and describe that professionals in the tax practice use the terms risk and uncertainty interchangeably. For this analysis, I do not differentiate between tax risk and tax uncertainty.

Because most tax measures used in prior literature, such as effective tax rates or uncertain tax benefits, are outcome-based measures, they may provide evidence on decisions the target management has made but may not provide insight to the array of risks which influenced the decision. Additionally, historical tax attributes of a target firm measured by effective tax rates and uncertain tax benefits may not persist for the combined firm post-acquisition. Thus, measuring tax risk *ex-ante* is most relevant for this setting.

Broadly, tax risk can be considered in terms of the risks inherent in a given tax strategy, or risks associated with proper execution of the tax strategy (Donohoe et al. 2014). While this categorization helps to organize our understanding of the potential sources of tax risk, how a firm manages those risks may be best considered through examining perceptions of tax risk across a firm's functions. Both Neuman et al. (2020) and Brühne and Schanz (2022) study perceptions of tax risk and determine that tax risk is a multifaceted construct which encompasses not simply the risks inherent in tax positions, but also risks of ongoing operations, reputational damage and compliance-related needs, among others. For example, a lack of timely communication, sufficiently detailed data, or knowledge of tax law and regulations can increase the chance that tax outcomes differ from expectation, leading to higher tax risk (Brühne and Schanz 2022). Based on conversations with tax practitioners, Brühne and Schanz (2022) construct a set of components to define tax risk which include financial, reputational, compliance, political, tax process, and personal liability risk. Neuman et al. (2020) operationalize the PwC tax risk management framework into a new measure of tax risk which considers the following risk areas: transaction, operating, compliance, financial accounting, managerial and reputation risks. The similarities in components across these studies suggest some convergence on the definition of tax risk.

Defining tax risk broadly in this manner highlights the complexity involved in tax risk research but aligns with tax risk management practices of firms and encompasses the range of concerns that management considers when analyzing tax implications of a new investment.

2.2 Management's response to tax risk

Many studies have demonstrated that upper management plays an important role in determining a firm's tax positions (Dyreng et al. 2010; McGuire et al. 2014; Hanlon et al. 2021).

Studies have also shown that management's tolerance for tax risk may be influenced by their compensation (Rego and Wilson 2012; Brown et al. 2016) or by the overall firm strategy (Higgins et al. 2015). Reputational risks have also been shown to be important to executives (Graham et al. 2014; Brühne and Schanz 2022), although empirical evidence of this effect is minimal (Gallemore et al. 2014; Asay et al. 2024).

To assess how a firm manages tax risk, and the effectiveness of this management, it is important to explore how tax risk impacts real decisions of managers. Studies analyzing consequences of tax risk and management's response have focused predominantly on macroeconomic risks, such as tax policy uncertainty or tax authority aggressiveness. In response to these risks, management delays large investments (Jacob et al. 2021) and acquires targets at a lower premium (Klassen and Mescall 2018). Managers who engage in risky tax strategies may also alter their financial disclosures to reduce risks of tax authority audits or reduce the chance of reputational damage (Robinson and Schmidt 2013; Hope et al. 2013; Chychyla et al. 2022).

According to the Scholes-Wolfson framework, management interested in maximizing after-tax returns should assess a tax strategy by factoring in all taxes, all parties, and all costs (Scholes and Wolfson 1992). The effectiveness of this approach, then, depends on the quality of the analysis of each component. Because tax outcomes are idiosyncratic, that is, highly dependent on a firm's unique current and prior tax positions, analyzing how management responds to particular risks is difficult and requires a setting where tax risk could be material and identifiable. Thus, to assess this question, I analyze the mergers and acquisitions (M&A) setting. Specifically, I examine ex-ante tax risks of the target firm and their associated effect on M&A due diligence and financial reporting outcomes.

M&A activities pose various financial accounting risks that have been well studied in the literature. In particular, Doyle et al. (2007) find that internal control weaknesses are more prevalent for firms undergoing restructuring. Through survey evidence, Maksymov et al. (2025) find that departure of experienced employees is expected in a restructuring, and that this loss of knowledge can contribute to material control weaknesses. The authors also report that executives consistently find that income tax provisions pose particular challenges to a firm's control environment. In their study of German firms, Gehrke et al. (2021) find that a majority of the employees lost in an M&A restructuring are from the target firm. Because the existence of internal control weaknesses can increase the likelihood of material financial misstatements, studying the impact of tax risks on financial reporting outcomes is particularly relevant in the M&A setting.

3. Hypothesis Development

The acquiring firm must understand all material risks of the target firm being acquired to negotiate the best price and maximize acquisition efficiency (Wangerin 2019; Deloitte 2016). Prior research has investigated the influence of many target firm tax characteristics on M&A outcomes. Much of this literature focuses on the influence of these characteristics on acquisition pricing, finding that premiums are lower when targets engage in aggressive tax strategies such as sheltering (Chow et al. 2016; Martin et al. 2017), are located in countries with high transfer pricing risk (Mescall and Klassen 2018), and when the target firm is private (Officer 2007). These studies suggest that tax risk of the target firm is associated with lower acquisition premiums, although there is evidence that uncertainty around future tax obligations of a target firm may actually increase the premium (Skaife and Wangerin 2013; Stomberg 2013). Research on deal structure provides little evidence that target firm tax characteristics influence the form of

consideration (Erickson 1998); however, the tax structuring of the deal may impact acquisition premiums (Erickson and Wang 2000; 2007).

In their review of the literature, Hanlon and Heizman (2010) indicate that little is known about the influence of target firm tax risk on acquisition pricing or deal negotiations. As described above, in the years since this review, many studies have explored the effects of tax characteristics on pricing. However, there is still a lack of studies exploring the impact of tax risk on aspects of deal negotiations outside of transaction structuring. Because deal negotiations are private, I am limited in my analysis to publicly observable aspects of the negotiation process. I develop my first hypotheses from the perspective of observable decisions available to management during negotiations.

3.1 Likelihood of Withdrawal

In their 2019 M&A survey, EY found that 76% of the survey respondents were part of deal negotiations that fell through, and approximately a third cited tax issues as a major reason.[2] While it's not clear what tax issues may cause deals to fail, this surprising survey result may suggest that some target firms have significant tax risks which cannot otherwise be mitigated through adjustments to acquisition pricing (Skaife and Wangerin 2013; Denis and Macias 2013). In the deal announcement, target firm management typically provides both financial and tax representations. Financial representations generally indicate that the target firm prepares financial statements according to U.S. GAAP. Tax representations typically state that the target firm has filed all required tax returns and paid all required taxes. If an acquirer discovers during

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[2] The archived webpage is available at:
https://web.archive.org/web/20240417221419/https://www.ey.com/en_be/tax/how-shifting-tax-rules-can-complicate-m-a-deals

its tax due diligence that a target firm has undisclosed (or "hidden") tax liabilities, it may amount

to a breach of target management's representations which can lead to deal cancellation.

Additionally, the M&A transaction itself can create new risks for transaction structuring. If risks

and structuring issues are severe, the parties may instead choose to abandon the transaction

(Roedl & Partner 2022; Palko 2022). Thus, the decision to withdraw from the deal is the first

aspect I consider. Because tax strategies and positions are not public information, an acquirer

may not be aware of a target's significant risks until deal negotiations are underway. Therefore, it

is possible that deals which have been announced can later fall through once the acquirer obtains

more information about the target firm. Because there is little reason to expect tax risk to be

associated with a lower likelihood of withdrawal, I state my first hypothesis directionally:

H1: Tax risk in target firms is associated with an increased likelihood of deal withdrawal.

3.2 Due Diligence Effort

My second hypothesis centers around the impact of tax risk on effort applied in due

diligence. Due diligence during M&A is the process undertaken by the acquirer to assess the

risks and opportunities involved in an acquisition (Wangerin 2019; Deloitte 2016; Lajoux and

Elson 2000). While due diligence generally encompasses assessing all aspects of the target firm,

financial and tax due diligence are a key aspect. Particularly for large mergers, due diligence can

be costly, time-consuming, and disruptive to ongoing operations (Deloitte 2016). Management of

the acquirer may have incentives to cut due diligence short to facilitate a quicker deal closing,

minimizing costs and disruption (Lajoux and Elson 2000). Evidence suggests that high quality

target firm accounting information is associated with shorter due diligence (Marquardt and Zur

2015), but also that shorter due diligence is associated with lower post-acquisition performance

and increased likelihood of impairments to goodwill (Wangerin 2019). Skaife and Wangerin

(2013) describe the three phases of due diligence to be preliminary due diligence, due diligence review (DDR), and transactional due diligence (TDD). The preliminary due diligence period occurs prior to public announcement and in this phase the acquirer is limited to publicly available information make its assessments. The DDR period occurs after signing a confidentiality agreement with the prospective target, but prior to public announcement of a deal. In this phase, the acquirer has limited private information from the prospective target. After the acquisition agreement is publicly announced, the TDD phase begins and the acquirer obtains more private information, analyzes the accuracy of representations and warranties made by the target firm's management, and finalizes the pricing and transaction terms and the deal structure.

Tax due diligence generally involves a review of the target's historical tax return filings and an assessment of potential sources of unreported or future tax liabilities (Thomson Reuters 2024). Because tax filings are private, information about a target's tax risks may not be discovered by the acquiring firm until they are well into the due diligence process, which is likely to occur after confidentiality agreements have been signed or after the deal has been publicly announced. Because identification of tax issues can increase the time and effort required to assess the target, I predict that tax risk in the target firm is associated with longer due diligence periods and more fees paid to external advisors. Because it is unlikely that high tax risk would be associated with shorter due diligence periods or lower fees, I state my second hypotheses directionally:

H2a: Tax risk in target firms is positively associated with longer due diligence periods.

H2b: Tax risk in target firms is positively associated with higher advisor fees.

3.3 Consequences of Tax Risk

My third hypothesis analyzes if tax risk is associated with adverse financial reporting outcomes in the combined firm post-acquisition. Because the goal of due diligence is to identify and mitigate risks associated with the target firm, longer due diligence periods may reflect more detailed assessment and planning around tax issues, which may mitigate future financial or operational consequences for the combined firm. Longer due diligence, though, may also reflect complex analysis, risks, or other adverse items discovered during due diligence which may or may not be fully resolved. Shorter due diligence periods, conversely, may result when analysis is straightforward and transparent, or may mean that important issues are overlooked, subjecting a firm to negative consequences in the future (Skaife & Wangerin 2013; Wangerin 2019). Thus, tax risk in target firms may lead to adverse outcomes in future periods regardless of the length of due diligence. Skaife and Wangerin (2013) find that target firms involved in cancelled deals are significantly more likely to report financial restatements in future periods, which they attribute to low quality financial reporting information. Wangerin (2019) finds that shorter transactional due diligence is associated with an increased likelihood of goodwill impairment, lower profitability of the combined firm, and lower quality fair value estimates of acquired assets and liabilities. Significant tax risk can reflect or increase overall information risk, which has been associated with an increased likelihood of financial restatements (Kravet and Shevlin 2010). Particularly in the M&A setting, this information risk can arise from difficulties integrating the knowledge around target firm operations with the acquiring firm in the post-acquisition period. Thus, I predict that tax risk could lead to an increased likelihood of financial misstatements for the combined firm in the future.

H3: Tax risk in target firms is positively associated with the likelihood of financial misstatements in the post-acquisition period.

4. Research Design

4.1 Tax Risk Measure

To study tax risk of target firms I replicate and extend the ex-ante tax risk measure (*TAXRISK*) developed by Neuman et al. (2020). This measure is built on the risk components of PwC's tax risk management framework, which reflect areas in a business that may be a source of tax risk. These risk components are transaction, operating, compliance, financial accounting, managerial, and reputational. To construct the measure, Neuman et al. (2020) identify three to four variables for each risk component and aggregate them by rank score. With the six component measures, the authors then use structural equation modelling to account for endogeneity of the compliance risk component and aggregate the components into a single measure. I follow these steps to construct the component measures and the aggregated *TAXRISK* measure.[3]

Many papers studying tax risk utilize measures such as adjusted ETRs, ETR volatility, or uncertain tax benefit (UTB) reserves. However, these measures may not be appropriate for my setting because they describe historical tax avoidance or risk practices and reflect prior decisions made by the target firm, which may not persist after the acquisition. In their assessment of the target firm, the acquirer's management should be most interested in *ex-ante* tax risk that will be absorbed by the acquirer in the acquisition. M&A deals, whether formally structured as an asset purchase or a stock purchase, can, for tax purposes, be structured as an asset acquisition through a Section 338(g) election. Upon making this election, the historical tax attributes of the target's assets are eliminated, and the acquirer steps up the assets' basis to fair market value. This suggests that historical risks proxied by UTBs, ETRs, or historical tax rate volatility may not

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[3] See the Online Appendix B from Neuman et al. (2020) for the details of this calculation.

represent realizable consequences for the acquiring firm in the post-acquisition period. Additionally, because ETRs and UTBs represent outcomes of the target firm's historical activities and decisions, these measures may not adequately represent the variety of risk considerations that are important to the acquirer.

A common practice in M&A transactions is to establish indemnities or escrow accounts to manage anticipated future cashflow impacts of a target's historical tax positions and further limit their ability to impact future reporting or operations. However, in my sample of public company M&A transactions, these remedies are not as readily available (Hopkins 2024), suggesting that a target firm's historical tax attributes may in fact lead to costly consequences for the combined firm. Neuman et al. (2020) find that their ex-ante *TAXRISK* measure is positively associated with firms' UTBs as well as other commonly used measures of tax risk, demonstrating that the measure encompasses concurrent tax attributes which generate future tax costs. This suggests that, to the extent that a target firm's tax positions or historical decisions lead to future adverse consequences, *TAXRISK* is expected to capture those effects.

To test for the influence of tax risk, I run each model described below using the aggregated and disaggregated *TAXRISK* measure. I first utilize the aggregated variable *TAXRISK* to determine if the overall ex-ante target tax risk influences management's decisions during the M&A process. Results from using this aggregated measure provide insight on the degree to which tax issues drive overall decision-making. Because I am interested in studying not only the effects of overall tax risk, but also the components that drive tax risk, I disaggregate *TAXRISK* into its six separate risk components to understand the influence of specific risk on management decision-making. From the risk components analysis, I seek to understand what areas of tax risk are most salient to management and will perform additional cross-sectional analyses to further

understand how specific areas of tax risk influence management decision-making in the M&A setting.

4.2 Likelihood of Withdrawal (H1)

The first decision I examine is the decision to withdraw from an announced deal. While withdrawal, or cancellation of the deal, could occur at any stage of the acquisition process, data on withdrawals is available publicly only for announced deals. Therefore, my tests do not consider the impact of tax risk on the decision to withdraw from negotiations prior to deal announcement, potentially limiting the generalizability of my results.

To test H1 I use the following logistic regression model:

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\begin{aligned}
Prob(WITHDRAWN = 1) = f(&TaxRisk, REC\_RESTATE, MKTVAL, BTM, EP, \\
&LEVERAGE, SGROWTH, LIQUIDITY, GRDUMMY, TANG, \\
&ROA, INST\_PCT, SHARED, SAME\_IND, ATERM, TTERM, \\
&TENDER, PCT\_STOCK, MBID, HOSTILE, N\_SUBSIDIARY, \\
&MKT\_CRASH, YearFE)
\end{aligned}
\tag{1}
$$

The dependent variable, *WITHDRAWN*, equals one when a deal is cancelled and zero otherwise. My variable of interest, *TaxRisk*, is either the aggregated *TAXRISK* measure or the disaggregated components described above. Following Amel-Zadeh and Zhang (2015) I include controls for recent target firm restatement announcements obtained from Audit Analytics (*REC_RESTATE*) along with other target characteristics including market value (*MKTVAL*), book-to-market (*BTM*), earnings-to-price (*EP*), leverage (*LEVERAGE*), sales growth (*SGROWTH*), liquidity (*LIQUIDITY*), growth-resource mismatch (*GRDUMMY*), tangibles (*TANG*), return on assets (*ROA*), institutional ownership (*INSTOWN_PERC*), and whether the target or acquirer is in the

same 2-digit SIC industry code (*SAME_IND*). To control for differences in target firm organizational complexity I include the number of target firm subsidiaries (*N_SUBSIDIARY*). All controls for target characteristics for this test are measured at the end of the fiscal prior to deal announcement.

I also include controls for deal-level characteristics. From Bates and Lemmon (2003), I control for the increased likelihood of deal completion associated with the presence of acquirer termination fee provisions (*ATERM*), target termination fee provisions (*TTERM*), tender offers (*TENDER*), and consideration paid in stock (*PCT_STOCK*). I also include controls for auctions (*MBID*) and hostile deals (*HOSTILE*) because these transactions are likely to lead to bid withdrawals for reasons outside of target firm fundamentals.[4] Finally, I also control for a market crash in the period between deal announcement and completion (*MKT_CRASH*) which is found to increase the probability of deal cancellation (Heath and Mitchell 2021). I also include year fixed effects to control for broader market effects that may influence the likelihood of withdrawal. Detailed descriptions for all variables are shown in the Appendix.

4.3 Due Diligence Effort (H2)

I use two proxies for manager effort in due diligence, the length of due diligence and advisory fees paid, to test my second hypothesis on the relationship between acquirer effort and target firm tax risk. First, I follow the approach in Wangerin (2019) and calculate the days in the due diligence review (*DaysDDR*) and transactional due diligence (*DaysTDD*) periods. The DDR period extends from the date of signing the initial confidentiality agreement through the acquisition agreement date. The TDD period extends from the acquisition agreement date through the date of deal closing. I take the natural log of the days in each period to calculate the

(2)

---

[4] Inferences are unchanged if auctions and hostile bids are removed from the sample.

dependent variables, ln(*DaysDDR*) and ln(*DaysTDD*). In an alternative measure of effort, I take

the natural log of advisor fees ln(*Fees*) attributable to the M&A transaction. I run an OLS

estimation of equation (2) to test the effect of tax risk on due diligence effort:

$$
\begin{aligned}
DD\_EFFORT = {}& \beta_0 + \beta_1 TaxRisk + \beta_2 \ln(\#ANALYSTS) + \beta_3 R\&D + \beta_4 DACC + \beta_5 SHARED \\
& + \beta_6 FAIRNESS\_OP + \beta_7 DEAL\_VAL + \beta_8 \sigma SALES + \beta_9 \sigma OCF + \beta_{10} BTM \\
& + \beta_{11} LEVERAGE + \beta_{12} PCT\_LOSS + \beta_{13} ROA + \beta_{14} HIGHTECH \\
& + \beta_{15} PCT\_STOCK + \beta_{16} CONTINGENT + \beta_{17} SAME\_IND + \beta_{18} TENDER \\
& + \beta_{19} MBID + \beta_{20} N\_SUBSIDIARY + \beta_j YearFE
\end{aligned}
$$

Consistent with Wangerin (2019), the variables ln(*#ANALYSTS*), *R&D*, and *DACC*

control for information risk of the target firm. I also control for differences in deal advisors

through *SHARED*, and *FAIRNESS_OP* and I control for target characteristics through $\sigma SALE$,

σOCF, *PCT_LOSS*, *ROA*, *LEVERAGE*, *BTM*, *HIGHTECH*, and *N_SUBSIDIARY*.[5] Finally, I also

control for transaction characteristics that may affect the length of due diligence: *DEAL_VAL*,

PCT_STOCK, *CONTINGENT*, *SAME_IND*, *TENDER*, and *HOSTILE*. For this test, I measure

target firm variables in the last fiscal year prior to deal close. All variables are defined in the

appendix.

4.3 Tax Risk Consequences (H3)

To test my third hypothesis analyzing the consequences of target firm tax risk on the

combined firm's financial reporting outcomes, I run the following logistic model:

(3)

---

[5] In controlling for deal advisor characteristics, Wangerin (2019) also includes indicator variables reflecting whether the acquirer employs a legal advisor in the top 5 of the SDC league tables and whether the acquirer discloses employing an independent valuation consultant. Due to data limitations, I am unable to include *Top Legal Advisor*, and *Valuation*. The coefficient on *Top Legal Advisor* is only weakly significant in one test from Wangerin (2019), but otherwise both are insignificant, suggesting they are unlikely to alter my conclusions.

$$Prob(Misstatement = 1) =$$

$$f(TaxRisk, ln(Fees), N\_SUBSIDIARY, CHG\_EMP, SHARED, DEAL\_VAL,$$

$$CAR, DACC, LEVERAGE, BTM, EP, R\&D, MKTVAL, ROA, YearFE)$$

I measure financial misstatements across the three fiscal years following deal close using the

financial restatement database from Audit Analytics. I create an indicator variable equal to one if

there was a misstatement in the firm's financial statements during the fiscal year and zero

otherwise. To be included in the measure, I require that the relevant restatement period in Audit

Analytics begins after the acquisition effective date. This helps to ensure the misstatement is not

related to the acquirer's pre-acquisition financial reporting. I first examine tax-related

misstatements because these are likely to be associated with tax risk. Because high tax risk may

also reflect broader information risk in the target firm (Kravet and Shevlin 2010), for

completeness I also examine non-tax-related misstatements. Tax-related misstatements are

measured following Bauer (2016) as an indicator equal to one if the firm had a misstatement

related to a tax account, as coded in Audit Analytics, and zero otherwise. Non-tax misstatements

include all other relevant misstatements during the fiscal year.[6]

  For these tests, I include controls for variables that may influence the likelihood of a

financial misstatement in the post-acquisition period, all measured at the combined post-

acquisition firm level. I measure performance-matched discretionary accruals (*DACC*), size

(*MKTVAL*), return on assets (*ROA*), leverage (*LEVERAGE*), book-to-market ratio (*BTM*),

earnings-to-price ratio (*EP*), and research and development (*R&D*). Because employee turnover

can lead to a loss of knowledge and skill, I include a control for the change in employee count

(*CHG_EMP*) between the pre- and post-acquisition period, measured as the total employees in

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[6] In untabulated analysis, I separately examine acquisition-related misstatements to understand if tax risk is associated with lower quality accounting for the acquisition overall and do not find significant results.

the post-acquisition combined firm less the sum of the employees of the acquirer and target in the pre-period. In addition, firms that are more organizationally complex may have increased accounting complexity, which is shown to increase the likelihood of misreporting (Bushman et al. 2004; Peterson 2012), so I include a control for the number subsidiaries (*N_SUBSIDIARY*) as a proxy for complexity. I also include deal-level variables including deal value (*DEAL_VAL*), advisory fees (*ln(Fees)*), and whether or not the target and acquirer had the same auditor or advisor (*SHARED*). Following Bens et al. (2012), I also include the cumulative abnormal return to the acquirer's stock in the three days surrounding the deal announcement (*CAR*) as this has been shown to lead to an increased likelihood of misstatements in the post-acquisition period.

5. Sample and Descriptives

My sample begins with all M&A deals from the LSEG SDC M&A database between two US public companies announced in 2002 or later. I focus exclusively on US public companies for two key reasons. First, this helps to ensure that both companies are similarly subject to US tax law and US GAAP, which allows for more equitable comparisons across deals. Second, the *TAXRISK* measure from Neuman et al. (2020) is best suited for US corporations. Next, because I seek to study management's response to target firm tax risk, my identification necessitates that the acquirer does not have extensive prior knowledge of the target firm's internal operations before the deal negotiations begin. To help ensure this, I require that the acquirer owned less than 50% of the target firm before the deal announcement. I limit my sample to those deals where the acquirer seeks to own 100% of the target upon closing, which helps to ensure that the entirety of the target firm's operations are being considered by the acquirer. The deal status must be either Completed or Withdrawn. This yields 3,666 deals of which I could merge 2,369 observations

with Compustat identifiers for both acquirer and target. I drop a further 664 deals without a *TAXRISK* measure, leaving 1,705 deals as the baseline sample.

5.1 Sample for tests of H1

For tests of H1, I lose a further 720 observations with missing control variables, and 30 observations are dropped from the logit regression due to a lack of variation in the dependent variable across fixed effects groupings. Descriptive statistics for this sample are in Table 1, Panel A. The target firms in my sample have relatively low *LEVERAGE* and low *BTM*. Most target firms also have relatively low *TAXRISK*. The distribution of target firms is skewed slightly toward larger, high-growth firms with low earnings-to-price ratios. The deal level statistics show that most deals are between targets and acquirers in the same industry. A little more than six percent of target firms had multiple bidders, approximately fifteen percent were tender offers, and very few are considered hostile. Over eighty percent of the acquisition agreements included target termination fee provisions while only around twenty percent included acquirer termination fee provisions. The average deal consideration paid in stock is about 43 percent, while the 25th and 75th percentiles show zero and 100 percent, respectively, of the consideration paid in stock.

Correlations are shown in Table 1, Panel B. In line with prior studies, *WITHDRAWN* is positively and significantly correlated with *MBID*, *HOSTILE*, and *MKT_CRASH* and negatively and significantly correlated with *TENDER*, *ATERM*, and *TTERM*. This table also shows a positive correlation between *WITHDRAWN* and *TAXRISK*, though it is not significant at conventional levels, and reveals that the *TAXRISK* measure may be skewed toward larger firms given its high correlation with *MKTVAL* and *INSTOWN_PERC*.

5.2 Sample for tests of H2

For tests of H2, I include only completed deals, reducing the baseline sample to 1,518 observations. My sample is further reduced to 831 observations for which confidentiality dates were able to be obtained to facilitate calculating the length of due diligence periods. After removing observations with missing control variables, 508 remain for the due diligence tests.[7] Descriptive statistics for this sample are in Table 2, Panel A. The average number of days in the DDR period is 145, in line with the 143 days reported by Wangerin (2019). The average number of days in the TDD period is 118, similar to the 115 days in Wangerin (2019). Statistics for the common variables between this sample and my sample for H1 are generally similar, however, because of differences in the sample construction, slight differences are expected. First, this sample has lower average consideration paid in stock (*PCT_STOCK*), lower *MBID*, and more tender offers (*TENDER*) compared to the sample for H1. The target firms in this sample have slightly higher average *TAXRISK*, *LEVERAGE* and *N_SUBSIDIARY* and lower average *BTM*. Correlations for my sample for H2 are shown in Table 2, Panel B and are comparable to the correlations of my sample for H1.

5.3 Sample for tests of H3

To test H3, I examine acquirer firm-years over the three fiscal years following acquisition completion. To facilitate a robust analysis of the consequences of tax risk in this setting, I construct this sample and run initial tests considering only the impact of *TAXRISK* and its component measures on the likelihood of financial misstatements since ex-ante it's unclear how due diligence effort could impact the result. For these tests I start with my prior baseline sample, and after eliminating observations with missing independent variables, I'm left with an unbalanced sample of 551 unique acquirers across 746 deals, resulting in 2,002 firm-year

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[7] While this sample size is relatively small due my sampling criteria and requirement that all target firms have a non-missing *TAXRISK* measure, it remains comparable to the sample size from Wangerin (2019).

observations. Due to the use of logit estimation with both year and industry fixed effects, a further 208 firm-years are dropped from my tests due to a lack of variation in the dependent variable within the fixed effects groupings, resulting in 1,794 post-closing firm-years used in my tests.

Descriptive statistics for this sample show that on average, these acquisitions generated a negative *CAR* at deal announcement. Target firm *TAXRISK* and *DEAL_VAL* are slightly lower in in this sample compared with my sample for H2, but *ln(Fees)* and *SHARED* are similar.[8] Firm-level controls in this sample are measured for the combined firm in the post-acquisition period and thus are not directly comparable to the target firm controls from my previous samples. As expected, the firms in this sample are larger, with lower *BTM* and lower *R&D*. These firms also have higher *LEVERAGE*, *ROA*, and a larger number of subsidiaries compared to the prior samples' target firms.

6. Results

Table 4, Panel A presents results of tests of H1, which predicts that tax risk in the target firm is positively associated with the likelihood of withdrawal. Column (1) displays results of the aggregated ex-ante *TAXRISK* measure and column (2) displays results using the disaggregated tax risk components. The insignificant coefficient on *TAXRISK* in column (1) suggests that tax risk is not significantly associated with deal withdrawal incrementally beyond other identified drivers. As described by practitioners as well as in academic literature, tax is an important consideration but may not be a first-order driver of major business decisions (Graham 2003). Consistent with prior research, I find that the likelihood of withdrawal is positively associated

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[8] The *TAXRISK* measure in this sample is the target firm's pre-acquisition *TAXRISK*. Neither the tax risk measures, nor the deal-level controls vary across the three post-acquisition fiscal years of the combined firm utilized in the tests of H3.

with hostile bids, multiple bidders, and the occurrence of a market crash in the days immediately following the deal announcement, and that tender offers, and the presence of termination fee arrangements reduce the likelihood of withdrawal. Thus, the null result in column (1) may not be surprising and may reflect that tax, overall, does not drive the decision to withdraw.

To further explore the relationship between tax risk and the likelihood of withdrawal, I examine the disaggregated risk components, displayed in column (2). While five of the six components reflect a null result, the coefficient on *Operating Risk* is .205 and is significantly positive at the 1% level (one-tailed). Economically, this suggests that moving up one rank value in any of the *Operating Risk* subcomponent measures increases the likelihood of withdrawal by 23 percent. The *Operating Risk* measure is a sum of the tercile or quartile ranked subcomponents measuring foreign operations, overall sales volatility, the number of tax haven subsidiaries and the extent of foreign intellectual property. Foreign operations, intellectual property and tax havens are often implicated in aggressive tax strategies involving transfer pricing or tax sheltering. Chow et al. (2016) and Klassen and Mescall (2018) demonstrate that these more specific tax risks are associated with reduced premiums in the M&A setting. My finding suggests that these tax risks may influence the negotiation process beyond pricing by increasing the likelihood that the acquirer withdraws or that the deal is otherwise cancelled.

To provide some evidence that this result is incremental to overall organizational complexity, in my main tests I control for the total number of the target firm's subsidiaries disclosed in Exhibit 21 filings. To further examine the relationship between *Operating Risk* and a firm's organizational complexity, I conduct cross-sectional analysis by splitting the sample on the median number of subsidiaries. Table 4, Panel B displays these results. Columns (1) and (2) present results for the consolidated *TAXRISK* measure when the target firm's subsidiary count is

above- and below-median, respectively. Here I find that, for target firms with an above-median number of subsidiaries, *TAXRISK* is significantly associated with an increased likelihood of withdrawal. Similarly, in columns (3) and (4) I find that *Operating Risk* continues to be significantly associated with an increased likelihood of deal withdrawal across both subsamples. This cross-section suggests that the relationship between *TAXRISK* and the likelihood of deal withdrawal depends in part on the complexity of the target firm.

Next, I explore whether tax risk impacts the acquirer's effort during due diligence. To examine effort, I look at the length of due diligence periods and the total advisory fees paid related to the M&A transaction. First, to examine the length of due diligence I follow Wangerin (2019) and separately examine the DDR and TDD periods. Results of these tests are shown in Table 5, Panel A, columns (1) through (4). I find that *TAXRISK* is not associated with longer DDR periods but is weakly associated with longer TDD periods. Economically, this result suggests that a one unit increase in *TAXRISK* is associated with a 5 percent longer TDD period.

Extensive, detailed private information is typically not shared with the acquiring firm until transactional due diligence begins (Wangerin 2019). Thus, these results are consistent with the details of private tax information being revealed to the acquirer later in the due diligence process. Examination of the tax risk components in columns (2) and (4) suggests that this result is driven by *Managerial Risk*. Per Neuman et al. (2020), the PWC tax risk management framework defines managerial risk as the "risk of not having sufficient or diverse technical knowledge capital to properly integrate the activities of the tax function across various departments and divisions to successfully manage tax risk" (p. 1794). Thus, these results suggest that high managerial risk in the target firm corresponds to increased acquirer effort during due diligence.

As an alternative measure of effort, I examine the relationship between tax risk and advisory fees paid in M&A transaction. Results for *TAXRISK* and the separate components are shown in columns (5) and (6), respectively. The coefficient on *TAXRISK* in column (5) is positive and significant at the 5% level (one-tailed). Economically this suggests that a one unit increase in *TAXRISK* is associated with a 20 percent increase in advisory fees paid. Results in column (6) show that this appears to be driven by *Managerial Risk* and *Reputation Risk*.

To further explore these findings, I again conduct cross-sectional analysis splitting the sample at the median target firm subsidiary count. I expect and find that complex target firms should require increased due diligence effort when tax risk is high. Table 5, Panel B tabulates these results. Columns (1) and (2) present results for the length of the TDD period. The coefficient on *TAXRISK* in column (1), which reflects results for target firms with high organizational complexity, is 0.0895 and is significant at the 10% level (one-tailed). The coefficient in column (2), which reflects results for firms with low organizational complexity, is insignificant. I find similar results in columns (3) and (4) examining advisory fees paid. The coefficient on *TAXRISK* in column (3) is 0.35 and is significant at the 1 percent level (one-tailed). The coefficient in column (4) is insignificant. Analysis of the risk components in Panel C reveals that the association between *Managerial Risk* and TDD length is stronger when the target firm is less complex, but the association between *Managerial Risk* and advisory fees is stronger when the target firm is more complex. I also find that *Reputation Risk* is significantly associated with higher advisory fees when the target firm has greater organizational complexity.

While it's logical that an acquirer will expend more effort when the target firm is more complex and has a stronger reputation, understanding the relationship between *Managerial Risk* and due diligence effort is less straightforward. Harding and Rouse (2007) describe that acquirers

often lack adequate assessment of the "roles, capabilities, and attitudes of [the target firm's] people" (p. 125). The authors argue that this lack of understanding can lead to a loss of talent after the deal announcement as well as increased attrition and failures in integration after the deal closes. Additionally, they suggest that assessments should also consider rank and file employees rather than be focused exclusively on top managers. While the tax knowledge and capabilities of target firms have not been specifically examined in prior research, the results of my tests of H2 suggest that acquirers do, to some extent, expend more effort in due diligence when the target firm has higher personnel tax-related risks. These results appear to be consistent with the notion that acquirers in my sample are aware of, and respond to, personnel issues in M&A transactions.

The results of H1 and H2 provide new information on the role of tax risk in M&A due diligence and negotiations. However, the relevance of the risk to practice may depend on the whether or not tax risk leads to adverse consequences in the post-acquisition period. H3 predicts that tax risk in the target firm is positively associated with the likelihood of financial misstatements for the combined firm in the future. Results of these tests are presented in Table 6. Panel A, Column (1) examines the association between *TAXRISK* and the likelihood of tax-related misstatements occurring in the three fiscal years after deal closing. The coefficient on *TAXRISK* is 0.710 and is significant at the 5 percent level (one-tailed). This suggests that the likelihood of a tax-related misstatement doubles with a one unit increase in target firm *TAXRISK*. Column (2) examines the tax risk components. Only *Managerial Risk* is significantly associated with an increased likelihood of tax-related misstatements, suggesting the overall results are driven by personnel-related tax risks. Comparing these results to results from my test of H2 suggests that, while managers of the acquiring firm recognize and respond to personnel risks in

the target firm, the efforts during due diligence are not sufficient to mitigate adverse financial reporting consequences for the combined firm in the post-period.

Results in columns (1) and (2) also show that coefficients on *ln(Fees)* are negative and significant at the 5 percent level, suggesting increased advisory fees paid as a part of the M&A transaction reduces the likelihood of future tax-related misstatements. In un-tabulated analysis I do not find that the length of due diligence impacts the overall results.[9] The evidence that tax-related misstatements increase with target firm tax risk further supports that *TAXRISK* captures important ex-ante tax-related risks and suggests that these risks can lead to real adverse consequences to the acquiring firm.

Because high tax risk may be associated with a lower quality of overall financial reporting in the target firm, I also examine the impact of target firm tax risk on non-tax misstatements. These results are reported in Table 6, Panel A, columns (3) and (4). The coefficient on *TAXRISK* is 0.421 and is similarly significant at the 5 percent level. This suggests that the combined firm in the post period is 1.5 times more likely to have a non-tax financial misstatement when target firm *TAXRISK* increases by one unit. Component analysis suggests this result is driven by *Compliance Risk* and *Managerial Risk*. Because *Compliance Risk* in the target firm is positively associated with the target firm's size and number of geographic segments, this result may be consistent with an overall increased likelihood of restatements when the target firm is larger and more geographically dispersed. The significant coefficient on *Managerial Risk* suggests that personnel tax-related risks may be evidence of broader personnel risks in the target firm extending beyond the tax function.

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[9] In excluding due diligence length measures, which depend on obtaining confidentiality dates, I am able to utilize a larger sample of acquirers for the tests of H3 than were utilized in tests of H2.

These results provide evidence that the target firm's personnel risk is a key driver of financial misstatements in the post-acquisition period. They also suggest that advisory fees paid reduces the likelihood of tax-related misstatements. To explore these associations further I conduct a series of cross-sectional tests. A potential explanation for the relationship between *Managerial Risk* and tax-related misstatements relates to post-acquisition integration issues (e.g., Adams et al. 2025). If management of the acquiring firm determines that target firm tax personnel lack sufficient tax knowledge, then the acquirer may not be inclined to retain those employees, leading to poor knowledge transfer between the target and acquirer.

Because I cannot measure only tax department employees, I instead look at the overall change in employees in the pre- and post-acquisition periods. I calculate the change in employees as the difference between the total employees of the target and acquiring firms in the fiscal year prior to deal close and the total employees of the combined firm in the fiscal years post-acquisition. I split the sample on the median change in employee (*CHG_EMP*) and re-run my main analysis separately for each subsample. The median value of *CHG_EMP* .019, which suggests that approximately half of the sample experienced a reduction in total employees between the two firms in the pre-period and the combined firm in the post-period. These results are presented in Table 7, Panels A and B. In Panel A, the coefficient on *TAXRISK* is only significantly associated with tax-related misstatements in the subsample of firms with a below-median change in employees.[10] This result is consistent with the potential explanation that integration issues may drive increased tax-related misstatements.

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[10] Because the median of *CHG_EMP* is very close to zero, splitting the sample on zero instead of the median produces nearly identical results.

Next, I cross-sectionally examine how advisory fees, a proxy for due diligence effort, impact the relationship between *TAXRISK* and the likelihood of misstatements. Table 7, Panels C and D present these results. Interestingly, I find that firms with above-median advisory fees are significantly more likely to have both tax-related and non-tax-related misstatements in the post-acquisition period. Analysis of the subcomponents again demonstrates that this increased likelihood is primarily driven by *Managerial Risk*. Finally, in Table 7, Panels E and F, I cross-sectionally examine the impact of organizational complexity. Consistent with the cross-sectional tests for my first two hypotheses, I find that tax risk is concentrated in acquisitions of target firms with high organizational complexity. A comparison of the coefficients in Panel E, columns (1) and (3) suggests this effect is stronger for tax-related misstatements compared to non-tax-related misstatements. Further, I find, consistent with the other cross-sectional tests in Table 7, that this effect is primarily driven by *Managerial Risk*.

7. Conclusion

My findings suggest that tax risks are relevant to management decision-making in the M&A setting. I find that, while a target firm's overall tax risk is not associated with an increased likelihood of deal withdrawal, evidence suggests an increased likelihood of withdrawal in target firms with greater organizational complexity. I also find that target firm tax risk increases the acquirer's effort during due diligence as evidenced by an increased length of due diligence and the higher advisory fees. Finally, I find that target firm tax risk is associated with an increased likelihood of tax-related misstatements post-acquisition, and that this result is concentrated in deals that experienced total workforce reductions post-acquisition.

A comparison of the results across each hypothesis suggests that tax risks associated with the target firm's tax structure are the most salient risks to management during the due diligence

and negotiation period. However, my findings suggest that less salient risks, particularly those around employees and knowledge transfer, are also important and appear to drive increased advisory fees and increased tax-related financial misstatements. These results contribute to furthering our understanding of management's perception of, and response to, tax risk. My study also furthers our understanding of how tax risk influences the M&A negotiation process. Finally, I operationalize a relatively new measure of *ex-ante* tax risk and find that in this setting, it significantly predicts the likelihood of adverse financial reporting outcomes.

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Appendix – Variable Descriptions

TAXRISK	Measure of ex-ante tax risk replicated from Neuman et al. (2020). Calculation follows Neuman et al. (2020), with a modified reputational risk calculation required due to data limitations.
Transaction Risk	Transaction risk component of ex-ante TAXRISK measure. See Neuman et al. (2020).
Operating Risk	Operating risk component of ex-ante TAXRISK measure. See Neuman et al. (2020).
Compliance Risk	Compliance risk component of ex-ante TAXRISK measure. See Neuman et al. (2020).
FinAcct Risk	Financial Accounting risk component of ex-ante TAXRISK measure. See Neuman et al. (2020).
Managerial Risk	Managerial risk component of ex-ante TAXRISK measure. See Neuman et al. (2020).
Reputation Risk	Reputation risk component of ex-ante TAXRISK measure. See Neuman et al. (2020). Due to data limitations, I utilize *Fortune* magazine's ranking of most admired firms rather than the score.
WITHDRAWN	Indicator variable equal to 1 if the deal is withdrawn per LSEG SDC database and zero otherwise.
ln(DaysDDR)	Natural log of the number of days between the signing of the initial confidentiality agreement and the publicly announced acquisition agreement.
ln(DaysTDD)	Natural log of the number of days between
ln(FEES)	Natural log of total transaction-related fees paid to external advisors obtained from LSEG SDC database.
Restatement	Indicator variable equal to 1 if financial statements were restated and zero otherwise. Restatement data obtained from Audit Analytics.
Tax Restatement	Indicator variable equal to 1 if financial restatement impacted a tax account and zero otherwise, per Bauer (2016). Restatement data obtained from Audit Analytics.
Acq Restatement	Indicator variable equal to 1 if financial restatement impacted accounting for the acquisition and zero otherwise. Restatement data obtained from Audit Analytics.
REC_RESTATE	Indicator equal to 1 if the target firm announced a financial restatement in the year prior to the acquisition announcement.
PCT_STOCK	Percentage of consideration paid in stock. Data obtained from LSEG SDC.
MKTVAL	Market value of equity
BTM	Book value of equity divided by market value of equity
EP	Fiscal year earnings divided by year-end market price
LEVERAGE	Total current plus long term debt divided by total assets.
SGROWTH	Current sales divided by lagged sales, minus one.
LIQUIDITY	Cash and cash equivalents plus receivables divided by total assets.
GRDUMMY	An indicator variable equal to 1 if the firm either has low growth, high liquidity, and low leverage, or if the firm has high growth, low liquidity, and high leverage, and zero otherwise, per Amel-Zadeh and Zhang (2015). High and low values are determined with reference to the Compustat median in the year.
TANG	Total property, plant, and equipment divided by total assets.
ROA	Total operating income divided by average total assets.
INSTOWN_PCT	Percentage of total shares owned by institutional owners. Data obtained from WRDS.
SAME_IND	An indicator equal to 1 if the target and acquirer share the same 2-digit SIC industry code and zero otherwise.

MBID	An indicator equal to 1 if acquirers submit competing bids for a target. Data obtained from LSEG SDC.
HOSTILE	An indicator equal to 1 if the deal attitude is labeled hostile in the LSEG SDC database and zero otherwise.
TENDER	An indicator equal to 1 if the deal is a tender offer and zero otherwise. Data obtained from LSEG SDC database.
MKT_CRASH	An indicator equal to 1 if the market declined 10 percent or more in the 20 trading days after the deal announcement and zero otherwise, per Heath & Mitchell (2023).
ATERM	An indicator equal to 1 if the acquisition agreement contained an acquirer termination fee provision, and zero otherwise.
TTERM	An indicator equal to 1 if the acquisition agreement contained a target termination fee provision, and zero otherwise.
SHARED	An indicator equal to 1 if the target and acquirer share the same audit firm or advisor and zero otherwise.
FAIRNESS_OP	An indicator equal to 1 if the acquirer engaged a top investment banking firm to provide a fairness opinion and zero otherwise, from Wangerin (2019).
ln(DEALVAL)	Natural log of the total deal consideration. Data obtained from LSEG SDC database.
R&D	Total R&D expenses divided by lagged sales.
DACC	Quintile ranking of performance-matched discretionary accruals following Wangerin (2019).
σSALE	Quintile ranking of the standard deviation of target firm sales over the previous five years, following Wangerin (2019).
σOCF	Quintile ranking of the standard deviation of target firm cash flows over the previous five years following Wangerin (2019).
PCT_LOSS	Percentage of the previous five years in which the target firm reports a loss.
HIGHTECH	An indicator variable coded one if the target firm belongs to a high-tech industry (2-digit SIC codes 35, 36, 38, 73), and zero otherwise following Wangerin (2019).
CONTINGENT	An indicator variable coded one if the acquisition involves contingent consideration, and zero otherwise following Wangerin (2019).
CAR	Three-day cumulative abnormal return around the acquisition announcement using a market model to determine abnormal return following Bens et al. (2012).
CHG_EMP	The difference in total employment from the pre-acquisition to the post-acquisition period, calculated as the total employment of the combined firm in the fiscals years following deal close less the sum of target plus acquirer total employment as of the last fiscal year prior to deal close.
N_SUBSIDIARY	The number of unique subsidiaries reported in the target firm's Exhibit 21 filing in the last fiscal year prior to deal close.

Table 1: Sample for tests of H1

Panel A: Descriptive Statistics		N	Mean	SD	p25	Median	p75
Dependent Var	*WITHDRAWN*	955	0.088	0.283	0	0	0
Independent Vars	*TAXRISK*	955	-0.283	0.684	-0.787	-0.417	0.096
	Transaction Risk	955	2.347	1.605	1	2	3
	Operating Risk	955	3.817	2.939	2	3	5
	Compliance Risk	955	7.405	2.386	6	7	9
	Fin Acct Risk	955	7.829	2.472	6	8	10
	Managerial Risk	955	4.903	1.832	4	5	6
	Reputation Risk	955	6.181	1.709	5	6	7
Target Firm Controls	*REC_RESTATE*	955	0.097	0.297	0	0	0
	MKTVAL	955	5.558	1.583	4.384	5.429	6.599
	BTM	955	0.672	0.495	0.341	0.553	0.863
	EP	955	-0.066	0.362	-0.031	0.032	0.058
	LEVERAGE	955	0.139	0.158	0.005	0.089	0.214
	SGROWTH	955	0.112	0.337	-0.043	0.059	0.192
	LIQUIDITY	955	0.549	0.247	0.36	0.578	0.761
	GRDUMMY	955	0.371	0.483	0	0	1
	TANG	955	0.117	0.166	0.017	0.049	0.134
	ROA	955	0	0.154	-0.001	0.021	0.069
	INST_PCT	955	0.539	0.297	0.291	0.544	0.784
	N_SUBSIDIARY	955	10.818	22.33	0	4	12
Deal-Level Controls	*PCT_STOCK*	955	42.689	43.175	0	39.9	100
	SHARED	955	0.31	0.463	0	0	1
	SAME_IND	955	0.723	0.448	0	1	1
	MBID	955	0.066	0.248	0	0	0
	HOSTILE	955	0.008	0.091	0	0	0
	TENDER	955	0.15	0.357	0	0	0
	MKT_CRASH	955	0.016	0.124	0	0	0
	ATERM	955	0.221	0.415	0	0	0
	TTERM	955	0.807	0.395	1	1	1

This table presents descriptive statistics of the sample used to test H1. See appendix for variable definitions. All continuous variables are winsorized at the 1st and 99th percentiles.

Panel B: Correlations

	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)	(12)	(13)	(14)	(15)	(16)	(17)	(18)	(19)	(20)	(21)	(22)	(23)	(24)	(25)	(26)	(27)	(28)	(29)
(1) *WITHDRAWN*	1.00																												
(2) *TAXRISK*	0.06	1.00																											
(3) *Transaction Risk*	0.02	**0.56**	1.00																										
(4) *Operating Risk*	**0.09**	**0.85**	**0.37**	1.00																									
(5) *Compliance Risk*	0.00	**0.67**	**0.29**	**0.59**	1.00																								
(6) *Fin Acct Risk*	0.03	**-0.44**	-0.06	**-0.27**	**-0.35**	1.00																							
(7) *Managerial Risk*	0.05	**0.62**	**0.20**	**0.29**	**0.37**	**-0.17**	1.00																						
(8) *Reputation Risk*	-0.01	**0.56**	**0.19**	**0.36**	**0.43**	**-0.20**	**0.25**	1.00																					
(9) *REC_RESTATE*	0.05	**0.07**	0.05	**0.08**	**0.08**	**0.10**	**0.07**	0.05	1.00																				
(10) *PCT_STOCK*	-0.03	**-0.12**	**-0.13**	**-0.21**	0.00	-0.05	0.06	-0.01	-0.04	1.00																			
(11) *MKTVAL*	-0.01	**0.67**	**0.28**	**0.56**	**0.67**	**-0.46**	**0.35**	**0.48**	0.06	**-0.09**	1.00																		
(12) *BTM*	0.06	**-0.27**	**-0.16**	**-0.27**	**-0.16**	**0.19**	-0.05	**-0.18**	-0.01	**0.18**	**-0.54**	1.00																	
(13) *EP*	-0.06	0.04	**-0.18**	0.04	**0.15**	**-0.17**	0.06	0.06	0.00	-0.01	**0.32**	**-0.33**	1.00																
(14) *LEVERAGE*	0.00	**0.10**	**0.15**	0.02	**0.13**	0.05	**0.11**	**0.12**	0.04	0.03	**0.15**	-0.05	-0.04	1.00															
(15) *SGROWTH*	0.02	**0.09**	**0.09**	**0.07**	0.06	-0.02	0.06	0.03	0.01	0.02	**0.13**	**-0.19**	**0.12**	-0.01	1.00														
(16) *LIQUIDITY*	**-0.07**	**-0.23**	**-0.22**	**-0.25**	**-0.17**	**-0.13**	**-0.10**	0.13	-0.06	0.23	**-0.20**	0.10	-0.03	-0.04	0.01	1.00													
(17) *GRDUMMY*	-0.02	-0.05	-0.04	-0.03	-0.04	0.01	-0.06	0.04	-0.01	0.00	-0.03	**0.14**	**-0.11**	0.12	**-0.32**	0.04	1.00												
(18) *TANG*	**0.07**	0.00	**0.08**	0.02	-0.02	**0.15**	-0.02	0.01	0.01	**-0.15**	0.09	-0.07	-0.03	**0.35**	-0.05	**-0.61**	0.00	1.00											
(19) *ROA*	-0.03	**0.14**	**-0.08**	**0.16**	**0.25**	**-0.11**	0.08	-0.11	0.01	-0.04	0.30	-0.11	**0.52**	0.09	**0.11**	**-0.26**	0.09	0.07	1.00										
(20) *INST_PCT*	0.02	**0.61**	**0.33**	**0.54**	**0.52**	**-0.29**	**0.24**	0.51	0.04	**-0.26**	0.72	**-0.36**	**0.17**	0.09	**0.13**	**-0.27**	0.10	**0.14**	**0.18**	1.00									

	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)	(12)	(13)	(14)	(15)	(16)	(17)	(18)	(19)	(20)	(21)	(22)	(23)	(24)	(25)	(26)	(27)	(28)	(29)
(21) *SHARED*	-0.03	0.04	**-0.11**	0.02	-0.01	**-0.12**	**0.09**	0.01	-0.03	**0.10**	0.03	-0.04	0.06	0.06	-0.04	0.04	0.00	-0.04	0.04	**-0.07**	1.00								
(22) *SAME_IND*	-0.01	-0.01	-0.01	-0.06	0.06	-0.03	0.02	0.03	-0.02	**0.15**	0.01	**0.11**	-0.01	0.05	-0.01	**0.17**	**-0.08**	-0.03	**-0.08**	-0.03	**-0.08**	1.00							
(23) *MBID*	**0.36**	**0.14**	0.05	**0.12**	0.05	0.00	**0.13**	**0.09**	0.06	**-0.11**	0.06	-0.03	**-0.08**	0.01	0.01	**-0.10**	-0.06	**0.11**	-0.04	**0.12**	-0.04	0.02	1.00						
(24) *HOSTILE*	**0.22**	**0.13**	**0.08**	**0.14**	**0.12**	-0.05	0.03	**0.08**	0.01	-0.05	**0.08**	0.04	0.00	0.04	-0.05	-0.01	0.02	0.02	0.02	0.06	-0.01	0.06	**0.16**	1.00					
(25) *TENDER*	**-0.09**	0.05	**0.10**	**0.10**	-0.02	0.02	-0.06	0.03	-0.04	**-0.36**	0.05	**-0.11**	-0.05	**-0.12**	0.04	-0.03	0.02	0.03	**-0.12**	**0.17**	**-0.08**	-0.03	**0.07**	0.06	1.00				
(26) *MKT_CRASH*	**0.08**	0.04	-0.01	0.04	0.07	-0.01	0.03	0.01	-0.04	**0.07**	0.01	0.02	**-0.07**	0.00	0.06	0.02	-0.06	-0.01	**-0.09**	0.03	0.01	0.04	-0.03	-0.01	0.02	1.00			
(27) *ATERM*	**-0.09**	**0.11**	**0.10**	**0.07**	**0.12**	-0.05	**0.09**	0.05	0.03	**0.17**	**0.17**	**-0.07**	0.04	**-0.09**	-0.02	-0.06	0.02	**0.07**	0.04	**0.10**	**0.07**	0.05	0.01	-0.02	**-0.08**	0.06	1.00		
(28) *TTERM*	**-0.32**	0.02	0.01	0.02	0.00	-0.05	-0.02	0.00	0.01	0.00	0.04	**-0.10**	0.00	-0.01	**0.10**	0.00	0.02	0.00	0.04	0.01	0.05	-0.02	**-0.15**	**-0.16**	0.02	0.02	**0.15**	1.00	
(29) *N_SUBSIDIARY*	0.03	**0.50**	**0.22**	**0.46**	**0.37**	**-0.09**	**0.26**	**0.46**	**0.08**	-0.03	**0.40**	**-0.12**	0.01	**0.23**	-0.02	**-0.29**	0.00	**0.16**	**0.15**	**0.28**	0.01	-0.04	**0.07**	**0.11**	-0.04	0.03	0.06	**-0.07**	1.00

This table presents Pearson correlations of the sample used to test H1. See appendix for variable definitions. All continuous variables are winsorized at the 1st and 99th percentiles. Correlations significant at the 5% level or above are in bold.

Table 2: Sample for tests of H2

Panel A: Descriptive Statistics		N	Mean	SD	p25	Median	p75
Dependent Vars	DaysDDR	508	145.339	247.627	47	82	141
	ln(DaysDDR)	508	4.425	1.006	3.850	4.407	4.949
	DaysTDD	508	117.986	87.645	62	91	144
	ln(DaysTDD)	508	4.570	0.610	4.127	4.511	4.966
	$Fees (millions)	508	10.054	30.674	4.051	11.450	28.991
	ln(Fees)	508	2.308	1.370	1.399	2.438	3.367
Independent Vars	TAXRISK	508	0.127	0.773	-0.481	0.017	0.677
	Transaction Risk	508	3.053	1.669	2	3	4
	Operating Risk	508	5.522	3.276	3	5	8
	Compliance Risk	508	8.467	2.605	6	9	10
	Fin Acct Risk	508	7.541	2.488	6	7	9
	Managerial Risk	508	5.435	2.000	4	5	7
	Reputation Risk	508	6.677	1.894	5	7	8
Target Firm Controls	ln(#ANALYSTS)	508	1.948	0.752	1.386	1.946	2.485
	DACC	508	2.959	1.412	2	3	4
	R&D	508	0.408	1.433	0.000	0.061	0.211
	σSALE	508	2.996	1.416	2	3	4
	σOCF	508	2.996	1.416	2	3	4
	BTM	508	0.464	0.327	0.241	0.389	0.603
	LEVERAGE	508	0.184	0.186	0.000	0.154	0.308
	PCT_LOSS	508	0.393	0.390	0.0	0.2	0.8
	ROA	508	0.017	0.176	-0.017	0.059	0.113
	HIGHTECH	508	0.482	0.500	0	0	1
	N_SUBSIDIARY	508	22.715	36.742	1	10	26
Deal-Level Controls	PCT_STOCK	508	25.743	37.441	0.000	0.000	50.125
	SHARED	508	0.281	0.450	0	0	1
	CONTINGENT	508	0.010	0.099	0	0	0
	SAME_IND	508	0.661	0.474	0	1	1
	TENDER	508	0.234	0.424	0	0	0
	MBID	508	0.020	0.139	0	0	0
	FAIRNESS_OP	508	0.159	0.366	0	0	0
	DEAL_VAL	508	7.061	1.608	5.925	7.071	8.109

This table presents descriptive statistics of the sample used to test H2. See appendix for variable definitions. All continuous variables are winsorized at the 1st and 99th percentiles.

Panel B: Correlations

	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)	(12)	(13)	(14)	(15)	(16)	(17)	(18)	(19)	(20)	(21)	(22)	(23)	(24)	(25)	(26)	(27)	(28)	(29)	(30)	(31)	(32)
(1) *DaysDDR*	1.00																															
(2) *ln(DaysDDR)*	**0.69**	1.00																														
(3) *DaysTDD*	-0.07	**-0.12**	1.00																													
(4) *ln(DaysTDD)*	-0.06	**-0.10**	**0.92**	1.00																												
(5) *$Fees (millions)*	-0.09	**-0.21**	**0.41**	**0.36**	1.00																											
(6) *ln(Fees)*	-0.08	**-0.19**	**0.32**	**0.30**	**0.81**	1.00																										
(7) *TAXRISK*	-0.07	**-0.15**	**0.26**	**0.27**	**0.42**	**0.43**	1.00																									
(8) *Transaction Risk*	0.03	-0.04	**0.12**	**0.13**	**0.21**	**0.20**	**0.55**	1.00																								
(9) *Operating Risk*	-0.04	**-0.12**	**0.16**	**0.18**	**0.31**	**0.32**	**0.87**	**0.31**	1.00																							
(10) *Compliance Risk*	**-0.10**	**-0.21**	**0.31**	**0.31**	**0.48**	**0.46**	**0.69**	**0.32**	**0.60**	1.00																						
(11) *Fin Acct Risk*	0.08	**0.14**	**-0.12**	**-0.13**	**-0.35**	**-0.31**	**-0.48**	-0.08	**-0.37**	**-0.39**	1.00																					
(12) *Managerial Risk*	**-0.11**	**-0.12**	**0.29**	**0.30**	**0.28**	**0.32**	**0.71**	**0.33**	**0.42**	**0.44**	**-0.21**	1.00																				
(13) *Reputation Risk*	-0.05	**-0.11**	**0.16**	**0.16**	**0.28**	**0.33**	**0.53**	**0.20**	**0.33**	**0.45**	**-0.17**	**0.27**	1.00																			
(14) *PCT_STOCK*	0.04	0.04	**0.23**	**0.35**	**0.19**	**0.13**	0.02	**0.11**	-0.01	0.05	0.01	0.03	-0.05	1.00																		
(15) *CONTINGENT*	0.02	0.04	-0.03	-0.02	-0.07	-0.07	-0.09	0.03	**-0.11**	-0.09	0.08	-0.03	-0.07	0.04	1.00																	
(16) *SAME_IND*	-0.02	-0.06	0.04	-0.01	0.04	0.04	**-0.10**	-0.05	**-0.11**	-0.04	-0.05	-0.07	-0.06	-0.03	0.07	1.00																
(17) *TENDER*	0.00	0.01	**-0.39**	**-0.58**	-0.06	-0.05	-0.09	-0.07	-0.03	**-0.10**	0.06	**-0.12**	-0.05	**-0.32**	0.04	**0.09**	1.00															
(18) *MBID*	-0.02	0.01	0.05	0.06	0.02	0.06	**0.10**	0.02	0.08	0.07	-0.08	0.04	**0.12**	-0.01	-0.01	0.07	0.02	1.00														
(19) *ln(#ANALYSTS)*	-0.09	**-0.22**	**0.17**	**0.18**	**0.52**	**0.49**	**0.47**	**0.17**	**0.38**	**0.51**	**-0.48**	**0.26**	**0.35**	**0.10**	-0.07	0.02	-0.03	0.03	1.00													
(20) *DACC*	0.06	0.06	-0.04	-0.02	-0.05	0.02	-0.02	0.00	-0.03	-0.05	**0.10**	0.03	0.01	-0.03	0.02	0.04	0.00	-0.04	0.01	1.00												
(21) *SHARED*	-0.07	-0.05	**0.14**	**0.10**	**0.11**	**0.15**	**0.10**	-0.01	**0.11**	**0.14**	**-0.11**	0.04	0.06	0.00	0.03	-0.01	-0.03	0.01	**0.14**	0.00	1.00											
(22) *FAIRNESS_OP*	-0.03	-0.04	**0.19**	**0.26**	**0.29**	**0.26**	**0.16**	0.06	**0.12**	**0.25**	**-0.13**	**0.11**	**0.11**	**0.34**	-0.04	-0.03	**-0.22**	0.02	**0.22**	-0.07	0.04	1.00										
(23) *DEAL_VAL*	**-0.14**	**-0.31**	**0.36**	**0.34**	**0.76**	**0.69**	**0.59**	**0.25**	**0.44**	**0.67**	**-0.50**	**0.41**	**0.44**	0.05	**-0.12**	-0.02	-0.08	0.05	**0.73**	-0.06	**0.14**	**0.25**	1.00									
(24) *σSALE*	**-0.13**	**-0.22**	**0.35**	**0.38**	**0.48**	**0.50**	**0.58**	**0.27**	**0.44**	**0.58**	**-0.35**	**0.46**	**0.39**	**0.16**	**-0.13**	**-0.11**	**-0.18**	0.06	**0.57**	0.02	**0.13**	**0.32**	**0.68**	1.00								
(25) *σOCF*	-0.07	**-0.18**	**0.35**	**0.38**	**0.51**	**0.50**	**0.49**	**0.23**	**0.35**	**0.56**	**-0.38**	**0.37**	**0.35**	**0.20**	-0.06	0.01	**-0.15**	0.08	**0.55**	0.04	**0.10**	**0.29**	**0.66**	**0.73**	1.00							
(26) *BTM*	0.06	0.08	-0.04	-0.01	**-0.22**	**-0.20**	-0.08	0.06	-0.07	-0.04	**0.16**	-0.04	**-0.10**	**0.10**	0.05	0.05	-0.04	0.02	**-0.19**	0.07	-0.08	0.04	**-0.31**	0.00	-0.02	1.00						
(27) *LEVERAGE*	0.00	-0.03	**0.31**	**0.34**	**0.24**	**0.27**	**0.16**	**0.23**	0.00	**0.30**	0.02	**0.20**	**0.22**	**0.19**	-0.07	-0.04	**-0.20**	-0.02	**0.12**	-0.07	**0.09**	**0.18**	**0.27**	**0.38**	**0.33**	-0.01	1.00					
(28) *PCT_LOSS*	0.08	**0.13**	**-0.22**	**-0.27**	**-0.19**	**-0.16**	**-0.32**	-0.05	**-0.25**	**-0.36**	**0.20**	**-0.28**	**-0.26**	0.02	**0.16**	**0.12**	**0.18**	-0.05	**-0.21**	**0.11**	-0.04	**-0.11**	**-0.35**	**-0.38**	**-0.18**	-0.04	**-0.12**	1.00				
(29) *ROA*	**-0.11**	**-0.14**	**0.18**	**0.23**	**0.15**	**0.14**	**0.24**	0.00	**0.23**	**0.32**	**-0.14**	**0.18**	**0.21**	-0.05	**-0.24**	**-0.17**	**-0.21**	0.06	**0.18**	-0.04	0.02	**0.14**	**0.33**	**0.36**	**0.16**	-0.07	**0.10**	**-0.62**	1.00			
(30) *HIGHTECH*	0.06	0.08	**-0.18**	**-0.20**	**-0.11**	**-0.15**	0.09	0.01	**0.26**	-0.08	**-0.10**	**-0.12**	**-0.14**	**-0.10**	**-0.10**	0.02	**0.10**	0.01	-0.04	0.01	0.03	**-0.14**	**-0.17**	**-0.22**	**-0.24**	-0.05	**-0.40**	0.08	0.01	1.00		
(31) *R&D*	**0.11**	0.07	**-0.11**	**-0.15**	0.02	0.01	**-0.10**	-0.01	**-0.15**	-0.03	-0.04	-0.06	-0.01	-0.02	0.07	**0.16**	**0.17**	-0.03	-0.01	-0.02	0.01	**-0.11**	-0.02	**-0.26**	0.01	-0.05	-0.05	**0.34**	**-0.55**	**-0.16**	1.00	
(32) *N SUBSIDIARY*	-0.05	-0.08	**0.33**	**0.34**	**0.4**	**0.36**	**0.49**	**0.29**	**0.39**	**0.42**	**-0.18**	**0.34**	**0.42**	**0.11**	-0.06	-0.07	**-0.17**	0.01	**0.23**	-0.01	0.03	**0.2**	**0.4**	**0.44**	**0.34**	0.00	**0.27**	**-0.26**	**0.21**	**-0.1**	**-0.14**	1.00

This table presents Pearson correlations of sample used to test H2. See appendix for variable definitions. All continuous variables are winsorized at the 1st and 99th percentiles. Correlations significant at the 5% level or above are in bold.

Table 3: Sample for tests of H3

Panel A: Descriptive Statistics		N	Mean	SD	p25	Median	p75
Dependent Vars	*Tax Misstatement*	1794	0.022	0.146	0	0	0
	Non-Tax Misstatement	1794	0.070	0.256	0	0	0
Independent Vars	*TAXRISK*	1794	0.013	0.796	-0.590	-0.095	0.522
	Transaction Risk	1794	2.953	1.767	1	3	4
	Operating Risk	1794	4.969	3.282	3	4	7
	Compliance Risk	1794	8.114	2.635	6	8	10
	Fin Acct Risk	1794	7.749	2.552	6	8	10
	Managerial Risk	1794	5.385	2.043	4	5	7
	Reputation Risk	1794	6.471	1.929	5	6	8
Firm-level Controls	*MKTVAL*	1794	8.472	1.880	7.225	8.439	9.794
	DACC	1794	3.005	1.424	2	3	4
	LEVERAGE	1794	0.280	0.182	0.151	0.265	0.392
	BTM	1794	0.500	0.358	0.271	0.439	0.660
	EP	1794	-0.036	0.308	-0.001	0.037	0.061
	R&D	1794	0.102	0.264	0	0.017	0.123
	ROA	1794	0.071	0.094	0.044	0.078	0.118
	CHG_EMP	1794	-0.324	17.273	-0.831	0.019	1.052
	N_SUBSIDIARY	1794	23.638	45.382	1	9	23
Deal-Level Controls	*ln(Fees)*	1794	2.012	1.387	0.875	2.06	3.127
	SHARED	1794	0.294	0.456	0	0	1
	DEAL_VAL	1794	6.702	1.704	5.514	6.682	7.860
	CAR	1794	-0.008	0.081	-0.046	-0.005	0.028

This table presents descriptive statistics of the sample used to test H3. See appendix for variable definitions. All continuous variables are winsorized at the 1st and 99th percentiles.

Panel B: Correlations

		(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)	(12)	(13)	(14)	(15)	(16)	(17)	(18)	(19)	(20)	(21)	(22)
(1)	*Tax Misstatement*	1.00																					
(2)	*Non-Tax Misstatement*	**0.27**	1.00																				
(3)	*TAXRISK*	**0.06**	**0.06**	1.00																			
(4)	*Transaction Risk*	0.02	0.04	**0.56**	1.00																		
(5)	*Operating Risk*	0.04	0.05	**0.86**	**0.33**	1.00																	
(6)	*Compliance Risk*	0.03	0.04	**0.72**	**0.32**	**0.64**	1.00																
(7)	*Fin Acct Risk*	-0.01	0.02	**-0.52**	**-0.14**	**-0.38**	**-0.43**	1.00															
(8)	*Managerial Risk*	**0.09**	**0.07**	**0.71**	**0.31**	**0.41**	**0.45**	**-0.26**	1.00														
(9)	*Reputation Risk*	0.02	0.01	**0.57**	**0.19**	**0.36**	**0.51**	**-0.25**	**0.31**	1.00													
(10)	*ln(Fees)*	0.00	-0.01	**0.53**	**0.27**	**0.38**	**0.52**	**-0.37**	**0.42**	**0.40**	1.00												
(11)	*N_SUBSIDIARY*	**0.05**	**0.06**	**0.51**	**0.28**	**0.44**	**0.40**	**-0.23**	**0.33**	**0.40**	**0.38**	1.00											
(12)	*CHG_EMP*	-0.01	-0.02	**-0.06**	-0.02	-0.04	0.00	**0.06**	**-0.08**	0.00	**-0.06**	-0.01	1.00										
(13)	*SHARED*	0.01	0.03	**0.17**	0.04	**0.16**	**0.18**	**-0.15**	**0.12**	0.08	**0.15**	0.04	-0.01	1.00									
(14)	*DEAL_VAL*	0.01	-0.02	**0.64**	**0.26**	**0.48**	**0.71**	**-0.50**	**0.47**	**0.50**	**0.73**	**0.41**	-0.03	**0.16**	1.00								
(15)	*CAR*	0.03	0.02	-0.05	-0.04	**-0.08**	-0.02	**0.05**	0.04	0.02	0.00	0.01	0.00	-0.02	-0.03	1.00							
(16)	*DACC*	0.00	**-0.06**	**-0.05**	-0.02	-0.04	-0.05	**0.06**	-0.01	**-0.07**	**-0.08**	**-0.05**	-0.05	**-0.06**	**-0.11**	0.01	1.00						
(17)	*LEVERAGE*	0.00	-0.02	**0.08**	**0.05**	-0.03	**0.15**	-0.04	**0.13**	**0.17**	**0.25**	**0.14**	-0.01	**0.05**	**0.24**	**0.11**	0.01	1.00					
(18)	*BTM*	0.04	**0.05**	0.03	0.03	0.02	0.00	0.01	0.02	0.04	-0.01	**0.06**	**-0.05**	0.01	-0.04	**-0.08**	0.00	**-0.19**	1.00				
(19)	*EP*	0.02	0.03	**0.05**	0.00	**0.05**	**0.08**	-0.02	0.05	**0.05**	0.03	0.00	0.03	0.02	**0.08**	**0.12**	0.02	**-0.17**	**-0.15**	1.00			
(20)	*R&D*	-0.02	-0.02	**-0.12**	-0.04	**-0.08**	**-0.14**	0.01	**-0.14**	**-0.10**	**-0.15**	**-0.12**	0.02	-0.05	**-0.21**	**-0.16**	0.01	**-0.20**	**-0.09**	**-0.12**	1.00		
(21)	*MKTVAL*	-0.02	-0.04	**0.38**	**0.14**	**0.32**	**0.42**	**-0.29**	**0.25**	**0.28**	**0.43**	**0.20**	0.04	**0.09**	**0.64**	**0.06**	-0.08	0.00	**-0.33**	**0.39**	**-0.20**	1.00	
(22)	*ROA*	-0.01	-0.02	**0.09**	0.02	**0.08**	**0.11**	-0.03	**0.09**	**0.07**	0.03	0.00	**0.05**	0.04	**0.17**	**0.18**	0.03	0.00	**-0.22**	**0.45**	**-0.49**	**0.46**	1.00

This table presents Pearson correlations of the sample used to test H3. See appendix for variable definitions. All continuous variables are winsorized at the 1st and 99th percentiles. Correlations significant at the 5% level or above are in bold.

Table 4: Likelihood of Withdrawal (H1)

Panel A: Main Analysis	Predicted sign	(1) WITHDRAWN	(2) WITHDRAWN
TAXRISK	+	0.427 (0.131)	
Transaction Risk	+		-0.0267 (0.596)
Operating Risk	+		0.205*** (0.005)
Compliance Risk	+		-0.128 (0.895)
Fin Acct Risk	+		-0.0138 (0.571)
Managerial Risk	+		-0.0716 (0.782)
Reputation Risk	+		-0.0785 (0.735)
REC_RESTATE		0.416 (0.360)	0.490 (0.291)
PCT_STOCK		0.00171 (0.657)	0.003 (0.390)
MKTVAL		0.0984 (0.613)	0.240 (0.287)
BTM		0.164 (0.657)	0.339 (0.386)
EP		-0.417 (0.313)	-0.427 (0.318)
LEVERAGE		-1.269 (0.256)	-0.475 (0.686)
SGROWTH		0.632 (0.164)	0.625 (0.168)
LIQUIDITY		-1.147 (0.211)	-1.009 (0.281)
GRDUMMY		0.0254 (0.939)	0.077 (0.820)
TANG		1.283 (0.244)	1.078 (0.341)
ROA		-0.0963 (0.938)	-0.412 (0.744)
INST_PCT		-1.259 (0.134)	-1.295 (0.158)

SHARED	-0.0399	-0.016
	(0.908)	(0.965)
SAME_IND	-0.662*	-0.652*
	(0.053)	(0.056)
MBID	3.200***	3.391***
	(0.000)	(0.000)
HOSTILE	3.862***	3.702***
	(0.005)	(0.007)
TENDER	-2.762***	-2.789***
	(0.000)	(0.000)
MKT_CRASH	2.088**	2.197**
	(0.011)	(0.011)
ATERM	-1.199**	-1.203**
	(0.014)	(0.015)
TTERM	-2.059***	-2.102***
	(0.000)	(0.000)
N_SUBSIDIARY	-0.0195*	-0.0217*
	(0.066)	(0.063)
Observations	955	955
Year FE	Yes	Yes
Pseudo R^2	0.391	0.408

Notes: This table presents logit estimation results of tests of H1, which predicts that tax risk in the target firm increases the likelihood of deal withdrawal. The dependent variable *WITHDRAWN* equals one for deals whose status is withdrawn in the LSEG SDC M&A database and zero otherwise. All continuous variables are winsorized at the 1st and 99th percentiles. See the appendix for full variable definitions. P-values are shown in parentheses. P-values are shown in parentheses; * $p < 0.10$, ** $p < 0.05$, *** $p < 0.01$. Significance is based on one-tailed p-values for the signed coefficients and two-tailed otherwise.

Panel B: Cross-sectional Analysis		(1)	(2)	(3)	(4)
N_SUBSIDIARY:		High	Low	High	Low
Predicted Sign		WITHDRAWN		WITHDRAWN	
TAXRISK	+	1.439**	-0.179		
		(0.023)	(0.614)		
Transaction Risk	+			0.0139	0.0266
				(0.475)	(0.436)
Operating Risk	+			0.388***	0.306**
				(0.006)	(0.022)
Compliance Risk	+			0.0629	-0.2090
				(0.372)	(0.916)
Fin Acct Risk	+			-0.409	0.147*
				(0.982)	(0.080)
Managerial Risk	+			-0.174	-0.129
				(0.817)	(0.839)
Reputation Risk	+			0.3000	-0.1930
				(0.152)	(0.809)
Controls		Yes	Yes	Yes	Yes
Observations		374	498	374	498
Year FE		Yes	Yes	Yes	Yes
Pseudo R²		0.545	0.421	0.603	0.456

Notes: This table presents logistic estimation results of cross-sectional tests of H1. The sample is split on the median number of target firm subsidiaries. Columns (1) and (3) display results where the target firm's subsidiary count is above the median, and columns (2) and (4) display results for target firms with below-median subsidiary counts. Subsidiary count is determined from Exhibit 21 disclosures, where missing observations are replaced with zero. Subsamples observations are unequal between groups as a result of both ties in the subsidiary counts and dropped observations due to fixed effects in the logit regression. Controls match the main analysis in Panel A and are omitted here for brevity. All continuous variables are winsorized at the 1st and 99th percentiles. See the appendix for full variable definitions. P-values are shown in parentheses; * $p < 0.10$, ** $p < 0.05$, *** $p < 0.01$. Significance is based on one-tailed p-values for the signed coefficients and two-tailed otherwise.

Panel A: Main Analysis							
		(1)	(2)	(3)	(4)	(5)	(6)
	Predicted Sign	ln(DaysDDR)		ln(DaysTDD)		ln(Fees)	
TAXRISK	+	0.0608		0.0533*		0.188**	
		(0.221)		(0.091)		(0.016)	
Transaction Risk	+		0.0097		-0.0155		0.0287
			(0.349)		(0.886)		(0.137)
Operating Risk	+		0.0103		0.00703		-0.0119
			(0.279)		(0.201)		(0.786)
Compliance Risk	+		-0.0177		0.00836		0.0311
			(0.744)		(0.231)		(0.167)
Fin Acct Risk	+		-0.0184		0.0104		-0.0168
			(0.836)		(0.154)		(0.869)
Managerial Risk	+		0.0025		0.0324**		0.0509**
			(0.465)		(0.011)		(0.047)
Reputation Risk	+		0.0124		-0.0236		0.0404*
			(0.284)		(0.951)		(0.068)
ln(#ANALYSTS)		0.0385	0.0265	-0.0772**	-0.0551*	-0.0651	-0.0646
		(0.676)	(0.771)	(0.034)	(0.098)	(0.470)	(0.483)
DACC		0.0343**	0.0364**	-0.000492	-0.0029	0.0502*	0.046
		(0.026)	(0.025)	(0.979)	(0.877)	(0.079)	(0.114)
R&D		0.0797**	0.0813**	-0.0385**	-0.0370**	-0.0146	-0.0271
		(0.033)	(0.029)	(0.012)	(0.020)	(0.436)	(0.203)
SHARED		-0.056	-0.0545	0.0613	0.0598	0.157	0.165
		(0.582)	(0.595)	(0.215)	(0.200)	(0.166)	(0.142)
FAIRNESS_OP		0.108	0.114	0.0269	0.0247	0.398**	0.400**
		(0.445)	(0.409)	(0.614)	(0.611)	(0.032)	(0.036)
DEAL_VAL		-0.257***	-0.252***	0.0682**	0.0680**	0.479***	0.447***
		(0.003)	(0.003)	(0.042)	(0.023)	0.000	0.000
σSALE		-0.0653	-0.0646	-0.0512***	-0.0570***	-0.0582	-0.0571
		(0.360)	(0.347)	(0.008)	(0.004)	(0.219)	(0.220)
σOCF		0.0438	0.0432	0.0772***	0.0782***	0.0432	0.0397
		(0.504)	(0.502)	(0.003)	(0.002)	(0.292)	(0.322)
BTM		-0.0575	-0.0347	-0.01360	-0.0192	-0.138	-0.172

	(1)	(2)	(3)	(4)	(5)	(6)
	(0.693)	(0.822)	(0.837)	(0.775)	(0.437)	(0.347)
LEVERAGE	0.437	0.488	0.279**	0.299**	0.0575	-0.104
	(0.177)	(0.135)	(0.021)	(0.019)	(0.751)	(0.627)
PCT_LOSS	-0.0184	-0.0206	-0.132*	-0.126**	0.184	0.218
	(0.915)	(0.904)	(0.055)	(0.049)	(0.236)	(0.173)
ROA	0.226	0.256	-0.0974	-0.103	-0.33	-0.338
	(0.601)	(0.550)	(0.619)	(0.579)	(0.400)	(0.376)
HIGHTECH	0.145	0.141	-0.101**	-0.0913*	-0.0281	0.0175
	(0.266)	(0.278)	(0.024)	(0.051)	(0.797)	(0.868)
PCT_STOCK	0.00082	0.000892	0.00280***	0.00266***	0.00172	0.00181
	(0.608)	(0.581)	0.000	0.000	(0.212)	(0.170)
CONTINGENT	0.194	0.216	0.122**	0.115*	-0.416***	-0.498***
	(0.483)	(0.426)	(0.027)	(0.083)	(0.002)	(0.003)
SAME_IND	-0.173**	-0.175**	0.0852	0.0846	0.064	0.0503
	(0.017)	(0.019)	(0.121)	(0.110)	(0.472)	(0.558)
MBID	0.346*	0.335*	0.193	0.234*	0.252**	0.221*
	(0.069)	(0.054)	(0.179)	(0.098)	(0.030)	(0.092)
TENDER	0.0411	0.0491	-0.641***	-0.641***	-0.0177	-0.0176
	(0.751)	(0.712)	0.000	0.000	(0.875)	(0.869)
N_SUBSIDIARY	0.0010	0.000936	0.00136*	0.00171**	0.00149	0.00133
	(0.401)	(0.429)	(0.055)	(0.022)	(0.124)	(0.229)
Constant	Yes	Yes	Yes	Yes	Yes	Yes
Observations	508	508	508	508	508	508
Year FE	Yes	Yes	Yes	Yes	Yes	Yes
Adjusted R^2	0.0919	0.0839	0.526	0.535	0.592	0.592

Notes: This table presents OLS results of tests of H2. The dependent variable in columns (1) and (2) is the natural logarithm of the days in the due diligence review (DDR) period. The dependent variable in columns (3) and (4) is the natural logarithm of the days in the transactional due diligence (TDD) period. The dependent variable in columns (5) and (6) is the natural logarithm of total advisory fees in the M&A transaction. All continuous variables are winsorized at the 1st and 99th percentiles. See the appendix for full variable definitions. P-values are shown in parentheses; * $p < 0.10$, ** $p < 0.05$, *** $p < 0.01$. Significance is based on one-tailed p-values for the signed coefficients and two-tailed otherwise. Standard errors are clustered at the acquirer industry level.

Panel B: Cross-sectional analysis of *TAXRISK*

	Predicted Sign	(1) High	(2) Low	(3) High	(4) Low
N_SUBSIDIARY:		ln(DaysTDD)		ln(Fees)	
TAXRISK	+	0.0895*	0.0641	0.350***	0.0452
		(0.088)	(0.161)	(0.010)	(0.286)
Controls		Yes	Yes	Yes	Yes
Observations		254	254	254	254
Year FE		Yes	Yes	Yes	Yes
Adjusted R^2		0.525	0.522	0.494	0.685

Panel C: Cross-sectional analysis of *TAXRISK* Components

	Predicted Sign	(1) High	(2) Low	(3) High	(4) Low
N_SUBSIDIARY:		ln(DaysTDD)		ln(Fees)	
Transaction Risk	+	-0.0237	-0.0117	0.041	0.0412
		(0.876)	(0.722)	(0.162)	(0.103)
Operating Risk	+	0.00702	0.0166*	0.000774	-0.0258
		(0.275)	(0.073)	(0.487)	(0.975)
Compliance Risk	+	0.0315*	-0.00275	0.0178	0.0167
		(0.059)	(0.597)	(0.342)	(0.336)
Fin Acct Risk	+	-0.0116	0.014	-0.0463	-0.0125
		(0.746)	(0.122)	(0.93)	(0.724)
Managerial Risk	+	0.0275	0.0317**	0.0863**	0.0244
		(0.114)	(0.016)	(0.023)	(0.170)
Reputation Risk	+	-0.00926	-0.0256	0.112***	-0.0327
		(0.711)	(0.937)	(0.004)	(0.797)
Controls		Yes	Yes	Yes	Yes
Observations		254	254	254	254
Year FE		Yes	Yes	Yes	Yes
Adjusted R^2		0.530	0.527	0.499	0.682

Notes: This table presents OLS results of cross-sectional tests of H2 splitting the sample on the median of *N_SUBSIDIARY*. A large number of subsidiaries reflect higher organizational complexity. All continuous variables are winsorized at the 1st and 99th percentiles. See the appendix for full variable definitions. Controls match the main analysis for H2 and are omitted here for brevity. P-values are shown in parentheses; * $p < 0.10$, ** $p < 0.05$, *** $p < 0.01$. Significance is based on one-tailed p-values for the signed coefficients and two-tailed otherwise. Standard errors are clustered at the acquirer industry level.

Table 6: Tax Risk Consequences (H3)

	Predicted Sign	(1)	(2)	(3)	(4)
		Tax Misstatement		Non-Tax Misstatement	
TAXRISK	+	0.710**		0.421**	
		(0.024)		(0.024)	
Transaction Risk	+		0.00491		0.0428
			(0.481)		(0.253)
Operating Risk	+		-0.0119		-0.03
			(0.565)		(0.727)
Compliance Risk	+		0.0342		0.127**
			(0.392)		(0.042)
Fin Acct Risk	+		-0.00141		0.0538
			(0.508)		(0.147)
Managerial Risk	+		0.348***		0.179***
			(0.001)		(0.005)
Reputation Risk	+		-0.0311		-0.037
			(0.607)		(0.702)
ln(Fees)		-0.286**	-0.317**	-0.115	-0.131
		(0.047)	(0.036)	(0.321)	(0.262)
N_SUBSIDIARY		0.00427	0.0062	0.00493	0.00567*
		(0.268)	(0.116)	(0.132)	(0.079)
CHG_EMP		-0.0159	-0.0183	-0.0196	-0.0197
		(0.493)	(0.447)	(0.145)	(0.152)
SHARED		0.0995	0.176	0.259	0.302
		(0.795)	(0.631)	(0.245)	(0.170)
DEAL_VAL		-0.102	-0.0883	-0.208*	-0.227*
		(0.594)	(0.703)	(0.092)	(0.092)
CAR		3.21	3.303	0.666	0.642
		(0.151)	(0.127)	(0.600)	(0.623)
DACC		0.0152	-0.016	-0.209***	-0.218***
		(0.891)	(0.883)	(0.002)	(0.001)
LEVERAGE		-0.554	-0.677	-0.384	-0.558
		(0.621)	(0.563)	(0.617)	(0.469)
BTM		0.259	0.342	0.189	0.26

	(1)	(2)	(3)	(4)
	(0.636)	(0.538)	(0.536)	(0.396)
EP	1.301	1.122	1.058*	0.991*
	(0.233)	(0.241)	(0.073)	(0.075)
R&D	-1.029	-0.999	-0.422	-0.403
	(0.117)	(0.126)	(0.440)	(0.457)
MKTVAL	-0.118	-0.088	-0.0702	-0.0534
	(0.473)	(0.588)	(0.511)	(0.614)
ROA	-1.872	-2.005	-2.478*	-2.654*
	(0.435)	(0.409)	(0.073)	(0.060)
Constant	Yes	Yes	Yes	Yes
Observations	1601	1601	1794	1794
Year & Industry FE	Yes	Yes	Yes	Yes
Pseudo R^2	0.124	0.147	0.0925	0.107

Notes: This table presents logit estimation results of tests of H3. The dependent variable in columns (1) and (2) equals one if the acquiring firm had a tax-related misstatement in the three fiscal years after the deal closed and zero otherwise. The dependent variable in columns (3) and (4) equals one if the firm had a non-tax-related misstatement during the same period. Misstatements are obtained from Audit Analytics restatement database, where the relevant restatement period must begin after the deal effective date. All continuous variables are winsorized at the 1st and 99th percentiles. Observations counts differ across regressions due to the use of fixed effects in the logit estimation. See the appendix for full variable definitions. P-values are shown in parentheses; * $p < 0.10$, ** $p < 0.05$, *** $p < 0.01$. Significance is based on one-tailed p-values for the signed coefficients and two-tailed otherwise. Standard errors are clustered at the firm level.

Table 7: Cross-sectional Analysis (H3)

Panel A: Cross-sectional analysis of *TAXRISK*

		(1)	(2)	(3)	(4)
	CHG_EMP:	High	Low	High	Low
	Predicted Sign	Tax Misstatement		Non-Tax Misstatement	
TAXRISK	+	0.200	1.340**	0.462**	0.650**
		(0.357)	(0.015)	(0.038)	(0.016)
Controls		Yes	Yes	Yes	Yes
Observations		540	451	752	859
Year & Industry FE		Yes	Yes	Yes	Yes
Pseudo R^2		0.102	0.281	0.127	0.161

Panel B: Cross-sectional analysis of *TAXRISK* Components

		(1)	(2)	(3)	(4)
	CHG_EMP:	High	Low	High	Low
	Predicted Sign	Tax Misstatement		Non-Tax Misstatement	
Transaction Risk	+	-0.204	0.136	0.0337	0.14*
		(0.905)	(0.180)	(0.366)	(0.082)
Operating Risk	+	-0.167	-0.0998	-0.0527	-0.0259
		(0.818)	(0.78)	(0.76)	(0.633)
Compliance Risk	+	0.131	0.261	0.283***	0.00535
		(0.305)	(0.123)	(0.005)	(0.482)
Fin Acct Risk	+	0.0939	-0.293*	-0.0398	0.0632
		(0.248)	(0.973)	(0.679)	(0.206)
Managerial Risk	+	0.450***	0.615***	0.168**	0.245***
		(0.004)	(0.004)	(0.042)	(0.009)
Reputation Risk	+	0.193*	-0.322	-0.225	0.0974
		(0.089)	(0.964)	(0.968)	(0.151)
Controls		Yes	Yes	Yes	Yes
Observations		540	451	752	859
Year & Industry FE		Yes	Yes	Yes	Yes
Pseudo R^2		0.154	0.366	0.155	0.179

Notes: This table presents logit estimation results of cross-sectional tests of H3. The sample is split on median *CHG_EMP*, calculated as the difference between the total employees of the target and acquirer before the merger, and the total employees of the combined firm after the merger. The dependent variable in columns (1) and (2) equals one if the acquiring firm had a tax-related restatement in the three fiscal years after the deal closed and zero otherwise. The dependent variable in columns (3) and (4) equals one if the firm had a non-tax-related restatement during the same period. All continuous variables are winsorized at the 1st and 99th percentiles. Observation counts differ across regressions due to the use of fixed effects in the logit estimation. See the appendix for full variable definitions. P-values are shown in parentheses; * $p < 0.10$, ** $p < 0.05$, *** $p < 0.01$. Significance is based on one-tailed p-values for the signed coefficients and two-tailed otherwise. Standard errors are clustered at the firm level.

Panel C: Cross-sectional analysis of *TAXRISK*

	Predicted Sign	(1) High	(2) Low	(5) High	(6) Low
ln(Fees):					
		Tax Misstatement		Non-Tax Misstatement	
TAXRISK	+	1.092**	0.14	0.708***	0.217
		(0.021)	(0.416)	(0.007)	(0.292)
Controls		Yes	Yes	Yes	Yes
Observations		516	493	846	854
Year & Industry FE		Yes	Yes	Yes	Yes
Pseudo R^2		0.312	0.190	0.165	0.0924

Panel D: Cross-sectional analysis of *TAXRISK* Components

	Predicted Sign	(1) High	(2) Low	(3) High	(4) Low
ln(Fees):					
		Tax Misstatement		Non-Tax Misstatement	
Transaction Risk	+	-0.117	-0.485	0.00934	-0.0458
		(0.722)	(0.987)	(0.464)	(0.695)
Operating Risk	+	0.000413	-0.272	0.0525	-0.148
		(0.499)	(0.934)	(0.241)	(0.933)
Compliance Risk	+	0.098	0.538***	0.0919	0.291**
		(0.358)	(0.005)	(0.189)	(0.015)
Fin Acct Risk	+	-0.0365	0.213**	0.0846	0.0516
		(0.601)	(0.049)	(0.159)	(0.235)
Managerial Risk	+	0.758***	0.463**	0.256**	0.166**
		(0.001)	(0.008)	(0.019)	(0.033)
Reputation Risk	+	-0.315	0.0739	0.0115	-0.0614
		(0.938)	(0.316)	(0.456)	(0.722)
Controls		Yes	Yes	Yes	Yes
Observations		516	493	846	854
Year & Industry FE		Yes	Yes	Yes	Yes
Pseudo R^2		0.381	0.270	0.181	0.119

Notes: This table presents logit estimation results of cross-sectional tests of H3 where the sample is split on median *ln(FEES)*. The dependent variable in columns (1) and (2) equals one if the acquiring firm had a tax-related restatement in the three fiscal years after the deal closed and zero otherwise. The dependent variable in columns (3) and (4) equals one if the firm had a non-tax-related restatement during the same period. All continuous variables are winsorized at the 1st and 99th percentiles. Observation counts differ across regressions due to the use of fixed effects in the logit estimation. See the appendix for full variable definitions. P-values are shown in parentheses; * $p < 0.10$, ** $p < 0.05$, *** $p < 0.01$. Significance is based on one-tailed p-values for the signed coefficients and two-tailed otherwise. Standard errors are clustered at the firm level.

Panel E: Cross-sectional analysis of *TAXRISK*

N_SUBSIDIARY:		(1) High	(2) Low	(3) High	(4) Low
		Tax Misstatement		Non-Tax Misstatement	
TAXRISK	+	1.117***	-0.832	0.533**	0.226
		(0.006)	(0.905)	(0.020)	(0.310)
Controls		Yes	Yes	Yes	Yes
Observations		558	421	831	704
Year & Industry FE		Yes	Yes	Yes	Yes
Pseudo R²		0.201	0.242	0.106	0.152

Panel F: Cross-sectional analysis of *TAXRISK* Components

N_SUBSIDIARY:		(1) High	(2) Low	(3) High	(4) Low
		Tax Misstatement		Non-Tax Misstatement	
Transaction Risk	+	0.117	-0.492	0.0935	-0.045
		(0.254)	(0.99)	(0.138)	(0.636)
Operating Risk	+	-0.0572	-0.477	-0.0327	-0.0434
		(0.697)	(0.936)	(0.718)	(0.615)
Compliance Risk	+	0.225	0.179	0.124	0.174
		(0.066)	(0.193)	(0.108)	(0.099)
Fin Acct Risk	+	-0.145	0.216	0.0814	-0.0492
		(0.892)	(0.117)	(0.124)	(0.73)
Managerial Risk	+	0.398**	0.618***	0.248**	0.0286
		(0.015)	(0.005)	(0.006)	(0.409)
Reputation Risk	+	0.030	-0.409	-0.00224	-0.0818
		(0.429)	(0.973)	(0.51)	(0.739)
Controls		Yes	Yes	Yes	Yes
Observations		558	421	831	704
Year & Industry FE		Yes	Yes	Yes	Yes
Pseudo R²		0.235	0.325	0.131	0.16

Notes: This table presents logit estimation results of cross-sectional tests of H3 where the sample is split on the median number of subsidiaries disclosed in Exhibit 21 filings. The dependent variable in columns (1) and (2) equals one if the acquiring firm had a tax-related restatement in the three fiscal years after the deal closed and zero otherwise. The dependent variable in columns (3) and (4) equals one if the firm had a non-tax-related restatement during the same period. All continuous variables are winsorized at the 1st and 99th percentiles. Observation counts differ across regressions due to the use of fixed effects in the logit estimation. See the appendix for full variable definitions. P-values are shown in parentheses. Standard errors are clustered at the firm level. Significance is based on one-tailed p-values for the signed coefficients and two-tailed otherwise.