TAX IMPLICATIONS ARISING FROM MERGERS AND ACQUISITIONS – AN INVESTIGATION OF AUSTRALIAN FIRMS

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Abstract

The tax and accounting literature indicates that mergers and acquisitions (M&As) have not been predominant in Australia until recently, but there is strong overseas evidence that suggests that this course of action can have significant tax implications. This paper investigates the presence, if any, of potential tax advantages obtained by Australian-based firms through M&A deals. Ninety-seven observations, comprising M&A deals completed between 2005 and 2015, were investigated to statistically support and explain the potential link between M&A decisions and certain corporate tax advantages gained. The findings suggest that when firms make profit-maximising decisions as part of an M&A deal, a potential reduction in tax can transpire from such transactions.

Keywords: *merger, acquisition, tax advantage*

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I INTRODUCTION

This study examines the level and impact of tax advantages or gains derived through corporate mergers and acquisitions in Australia. The study investigates the emergence of firms that engage in mergers and acquisitions and the potential tax advantages that may arise from taking this action.

There is a fine distinction between 'tax avoidance' and 'tax evasion', which is vital to understand in this context. Tax avoidance refers to the mechanism used to reduce tax liabilities while staying within the limits of the law, followed by full disclosure of information to the tax administration.[1] In contrast, tax evasion refers to the non-payment of tax through illegal practices. Tax evasion is, therefore, the deliberate misinterpretation or concealment of the facts and information with the purpose of reducing tax liabilities.[2]

The other significant approach used by firms to reduce their tax burden is through 'tax planning' or 'tax mitigation'. Tax planning can be described as a legal practice within the spirit and the letter of the law. It encompasses ways to minimise the tax burden without any illegal interference.[3] Further, tax mitigation has been defined as when a taxpayer obtains a tax saving or advantage by reducing income or incurring an expenditure.[4] A further definition of tax mitigation was provided in the case of *Ensign Shipping* which indicated that a taxpayer "suffers a loss or incurs expenditure in fact as well as in appearance."[5] Consequently, a distinction is drawn between tax mitigation[6] and unacceptable tax avoidance.

The terms 'merger and acquisition' also needs to be clarified as adopted in this study. Although the terms `merger' and `acquisition' are often used interchangeably, they are fundamentally different.[7] While mergers imply a unification of two entities into one, acquisitions involve one entity buying the other and absorbing it.[8] Merger and acquisition is also an umbrella term used for different types of mergers and acquisitions, namely, takeovers,

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1 Fariz Huseynov and Bonnie K Klamm, 'Tax Avoidance, Tax Management and Corporate Social Responsibility' (2012) 18(4) *Journal of Corporate Finance* 804.

2 Kristina Minnick and Tracy Noga, 'Do Corporate Governance Characteristics Influence Tax Management?' (2010) 16(5) *Journal of Corporate Finance* 703. For a detailed examination of the definitions of the concepts of tax evasion, avoidance and planning see Alexander Robert Fullarton, 'Miners' motivation - the mass-marketed tax avoidance schemes of the 1990s in the Pilbara region of Western Australia' (PhD thesis, University of New South Wales, 2013) <http://unsworks.unsw.edu.au/fapi/datastream/unsworks:11537/SOURCE01?view=true>.

3 Ada Ferrer-i-Carbonell and Klarita Gërxhani, 'Tax Evasion and Well-Being: A Study of the Social and Institutional Context in Central and Eastern Europe' (2016) 45 *European Journal of Political Economy* 149.

4 See *CIR v Challenge Corporation Ltd (1986).* An example would be conducting a business by way of a company rather than a sole trader so as to take advantage of a lower corporate tax rate.

5 *Ensign Shipping Co Ltd* v *CIR* (12 TC 1169).

6 The hallmark of tax mitigation is that the taxpayer takes advantage of a fiscally attractive option afforded to him under the tax legislation, and genuinely suffers the economic consequences that Parliament intended to be suffered by those taking advantage of that option. (*Sabah Berjaya* Sdn Bhd v Ketua Pengarah Jabatan Hasil Dalam Negeri (1999), at http://phl.hasil.gov.my/pdf/pdfam/Eli_Lili_High_Court.pdf).

7 Kyeong Hun Lee, David C Mauer and Emma Qianying Xu, 'Human Capital Relatedness and Mergers and Acquisitions' (2018) 129(1) *Journal of Financial Economics* 111.

8 Johannes Becker and Clemens Fuest, 'Source versus Residence Based Taxation with International Mergers and Acquisitions' (2011) 95(1–2) *Journal of Public Economics* 28.

consolidations, amalgamation, schemes of arrangements, selective buybacks, splits, and scheme implementations, to name a few.

There has been increased debate around the rise of merger and acquisition deals in recent times in Australia. While some studies emphasise the positive role, these deals play in allocating resources in society and favourably impacting market competition, there is also evidence highlighting the negative implications upon social welfare.[9] One prominent aspect frequently discussed in this context is that of tax rationale. It has been noted that in some cases, corporations and shareholders have had a clear rationale to reduce their taxes and increase personal and institutional financial gains.[10] Much of this literature pertains to Europe, China and the USA. The act of amalgamating firms can largely facilitate a reduction in taxes. For instance, mergers and acquisitions can lead to an increase in tax losses and sharing of depreciation deductions, and multiplication of tax credits.[11]

Given the definitional issues described above, the purpose of this study is to investigate the presence, if any, of potential tax advantages gained through merger and acquisition deals in Australia. While it is acknowledged that management's mindset and behavioural approach is a significant factor in determining the motivations behind such deals, this analysis is beyond the scope of the current study. Likewise, it is also not the intention of this research to conduct a legal analysis of potential tax avoidance established under *s 177* of the *ITAA 1936*.[12] Rather, the study aims to conduct a preliminary empirical investigation of the potential tax advantages and gains derived through merger and acquisition deals in Australia during 2005-2015.

This study will be of interest to academics and practitioners, given the growing trend in mergers and acquisitions, and the ever-increasing concern of the tax authorities to protect the revenue. The contribution of this paper is two-fold. Firstly, the study analyses Australian-based merger and acquisition firms,[13] thus broadening the scope of previous research, which largely ignored the aspect of corporate tax advantages gained by merger and acquisition firms based in Australia. Secondly, the research is not limited to high revenue companies. As such, this allows conclusions to be drawn that can be potentially extrapolated to all Australian-based companies, and not only those with high market capitalisation. The scope of this study is, however, limited to Australian-based firms. Consequently, the rationale for conducting the study is based on two main reasons:

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[9] Theo Eicher and Jong Woo Kang, 'Trade, Foreign Direct Investment or Acquisition: Optimal Entry Modes for Multinationals' (2005) 77(1) *Journal of Development Economics* 207; Henrik Horn and Lars Persson, 'The Equilibrium Ownership of an International Oligopoly' (2001) 53(2) *Journal of International Economics* 307; Pehr-Johan Norbäck and Lars Persson, 'Investment Liberalization — Why a Restrictive Cross-Border Merger Policy Can Be Counterproductive' (2007) 72(2) *Journal of International Economics* 366.

[10] Oliver Levine, 'Acquiring Growth' (2017) 126(2) *Journal of Financial Economics* 300.

[11] Grant Richardson, Bei Wang and Xinmin Zhang, 'Ownership Structure and Corporate Tax Avoidance: Evidence from Publicly Listed Private Firms in China' (2016) 12(2) *Journal of Contemporary Accounting & Economics* 141.

[12] *Income Tax Assessment Act 1936*.

[13] The term 'M&A firms', wherever used in the paper, means those firms, which have been involved in M&A deals and form a part of the analysis.

- Firstly, the considerable increase in merger and acquisition deals in the Australian business landscape in recent years (post-2015);[14] and
- Secondly, due to the increasing tax gap[15] in the country[16] the overall the study contributes to the literature by investigating the tax advantages, if any, gained by Australian companies with varied market capitalisation from different sectors involved in merger and acquisition deals, thereby enriching the study of corporate tax practices. As with other recent studies, this study has implications for Australia's budget that is highly dependent upon corporate tax,[17] which happens to be the second-largest source of Federal government revenue.[18]

This paper is structured as follows – following this introduction, section two reviews the relevant literature, identifies the existing research gap, and consequently, forms the relevant research hypothesis based on this discussion. Section three describes the methodology adopted in the study and identifies the sample selection, data collection and variables tested. Section four analyses the findings from the correlation results and discusses the relationship, if any, between the variables employed. The final section concludes by summarising the findings and puts forward some suggestions for further research into potential tax policy implications that arise from this investigation.

II LITERATURE REVIEW

A review of accounting literature reveals that mergers and acquisitions have notably increased worldwide, not only in value but also in terms of the amount of agreements over the past two decades,[19] thereby increasing their significance as a form of corporate investment or growth. Further, studies also reveal that the level of corporate tax advantages have crucially increased following the changing trends in businesses and the way firms operate in the contemporary environment.[20]

[14] 'Australian M&A Activity Is Booming, and the Recent Shift in Global Interest Rates May Help Explain Why', *Business Insider Australia* (29 October 2018) <https://www.businessinsider.com.au/australian-ma-activity-booming-2018-10>.

[15] Tax gap is defined as difference between the tax properly payable under the law and the tax actually collected (Huseynov & Klamm 2012, p. 812).

[16] Neil Warren, 'Estimating Tax Gap Is Everything to an Informed Response to the Digital Era' [2018] *SSRN Electronic Journal* https://www.ssrn.com/abstract=3200838; Grantley Taylor and Grant Richardson, 'Incentives for Corporate Tax Planning and Reporting: Empirical Evidence from Australia' (2014) 10(1) *Journal of Contemporary Accounting & Economics* 1; Grantley Taylor and Grant Richardson, 'International Corporate Tax Avoidance Practices: Evidence from Australian Firms' (2012) 47(4) *The International Journal of Accounting* 469.

[17] 'Revenue Statistics - OECD Countries: Comparative Tables' (2014) OECD, <https://stats.oecd.org/index.aspx?DataSetCode=REV>.

[18] As cited in Rodney Brown, Youngdeok Lim and Chris Evans, 'The impact of full franking credit refundability on corporate tax avoidance' (2020) 17(2) eJournal of Tax Research 134.

[19] 'M&A Global Outlook', *JP Morgan* (January 2019) <https://www.jpmorgan.com/insights/research/2019-ma-global-year-outlook>.

[20] Jeremiah Harris and William O'Brien, 'U.S. Worldwide Taxation and Domestic Mergers and Acquisitions' (2018) 66(2–3) *Journal of Accounting and Economics* 419.

The primary purpose of this study is to investigate the potential presence of tax advantages and savings, if any, gained through corporate mergers and acquisitions in Australia during the period 2005-2015.[21] It brings to light the critical question of whether or not firms that have been involved in merger and acquisition operations have gained tax advantages or savings as a result of the deals and whether firm size also contributed to the results achieved in conducting the merger and acquisition deal.

There is a plethora of literature covering the impact of merger and acquisition operations on corporate tax responsibilities. However, most studies and research are confined to those conducted in the United States and Europe. Since the research into the presence of mergers and acquisitions has been comparatively recent in Australia, it is noted that there is limited literature available covering this topic in the Australian context, therefore this study aims to address that gap in the research.

As suggested, this issue may also be significant due to the potential revenue leakage and distortion of business performance and reporting caused by merger and acquisition deals. Corporate tax compliance is an important issue that has concerned tax policymakers for a long time. It primarily impacts the tax collection and therefore, the ability of the government to meet its financial and policy targets. As economies become more globalised and the business environment continues to evolve, it is likely that the way tax regimes are designed and administered may also change.[22]

A *Corporate Tax Advantages*

There is evidence that most European and US-based firms are becoming tax aggressive and undertake tax schemes and planning to reduce their tax liabilities.[23] The issue is whether the structuring of merger and acquisition deals has resulted in tax savings or advantages. Unfortunately, few studies have been conducted on this subject within the Australian setting, making it hard to gauge the behaviour of the Australian-based firms regarding merger and acquisition deals. For those studies that have been completed, it is evident that various factors have contributed to reducing tax payments. Those factors include – profitability; the size of the firm; the administration; investors; and so forth.[24]

A variety of tax planning measures have also resulted in a decrease in tax payments.[25] However, one of the various measures found in the literature, among the most widely used,

[21] Since this study employs a method of comparative analysis, recent observations could not be included due to the lack of sufficient data from comparative periods of study.

[22] 'Taxation and electronic commerce: Implementing the Ottawa taxation framework conditions' (2001) OECD, <https://www.oecd.org/ctp/consumption/Taxation%20and%20eCommerce%202001.pdf>.

[23] Kenneth J Klassen and Stacie K Laplante, 'Are U.S. Multinational Corporations Becoming More Aggressive Income Shifters?: (2012) 50(5) *Journal of Accounting Research* 1245.

[24] See e.g. Sonja Olhoft Rego and Ryan Wilson, 'Equity Risk Incentives and Corporate Tax Aggressiveness' (2012) 50(3) *Journal of Accounting Research* 775; Cai Hongbiao and Rao Pingui, 'Institutional Investors, Tax Enforcement, and Corporate Tax Avoidance' (2015) 1(10) *Journal of Accounting Research* 59.

[25] Scott D Dyreng, Michelle Hanlon and Edward L Maydew, 'Long-Run Corporate Tax Avoidance' (2008) 83(1) *The Accounting Review* 61; Michelle Hanlon and Shane Heitzman, 'A Review of Tax Research' (2010) 50(2–3) *Journal of Accounting and Economics* 127.

are effective tax rates.[26] Other studies[27] have revealed that managers prefer using effective tax rates for decision-making processes.

Effective tax rates are average tax rates paid by corporations after other tax concessions have been taken into account. It is an especially useful metric for benchmarking two or more entities to understand the financial advantages or disadvantages that may have occurred due to several factors.[28]

Ciobanu and Dobre[29] investigated the potential tax-related reasons that investors seek when entering into merger and acquisition transactions. They collected data from 46 developing and developed countries and found that effective tax rates play a decisive role in such deals. Instead of comparing companies, this study draws a comparison between periods (pre- and post-merger and acquisition) within the same companies. This will assist in determining whether any tax advantages or gains were achieved after the merger and acquisition decision. This study also incorporates companies of different sizes to examine how the firm's size may have contributed to any tax advantages derived after completing merger and acquisition deals.

Prior international literature regarding the various factors that impact corporate tax following mergers and acquisitions is extensive. These factors include the firm's size,[30] the costs[31] , and the effects of top management's strategy.[32] Erickson[33] revealed that an increase in shareholder value or dividend payments could also affect corporate tax payments. Firms often engage in tax planning to increase dividends and this can also serve as a simple measure in determining the amount of corporate tax paid.

[26] Hanlon and Heitzman, (n 25).

[27] John R Graham, Michelle Hanlon, Terry Shevlin and Nemit Shroff, 'Incentives for Tax Planning and Avoidance: Evidence from the Field' (2014) 89(3) *The Accounting Review* 991.

[28] Alice Bonaime, Huseyin Gulen and Mihai Ion, 'Does Policy Uncertainty Affect Mergers and Acquisitions?' (2018) 129(3) *Journal of Financial Economics* 531.

[29] Radu Ciobanu and Elena Dobre, 'Are mergers and acquisitions influenced by taxation?' (2015) 3 *Journal of Financial and Actuarial Mathematics and Management* 57.

[30] For example see Lillian Mills, Merle Erickson and Edward L Maydew, 'Investments in Tax Planning' (1998) 20(1) *Journal of the American Taxation Association* 1; Sonja Olhoft Rego, 'Tax-Avoidance Activities of U.S. Multinational Corporations' (2003) 20(4) *Contemporary Accounting Research* 805.

[31] Rego (n 30) 805; Yudha Aryo Sudibyo and Sun Jianfu, 'Political Connections, State Owned Enterprises and Tax Avoidance: Evidence from Indonesia' (2016) 13(3) *Corporate Ownership and Control* 279.

[32] Scott D Dyreng, Michelle Hanlon and Edward L Maydew, 'The Effects of Executives on Corporate Tax Avoidance' (2010) 85(4) *The Accounting Review* 1163.

[33] Merle Erickson, 'The effect of taxes of the structure of corporate acquisitions' (1998) 36(2) *Journal of Accounting Research* 279.

B *Tax Considerations in Merger and Acquisition Deals*

A significant part of academic research is based on the notion that tax is one of the determinants of mergers and acquisitions at the corporate level and provides various concessions that may drive merger and acquisition deals. These may include; unused tax credits and tax losses[34] managing the asset base prior to the deal so that higher deductions are possible in the future,[35] the form of organisations involved in the deal,[36] capital structure adjustments to allow for tax-deductible interests,[37] and the tax advantages discussed earlier derived from firms paying dividends.[38]

Gul, Khedmati and Shams[39] found that those firms, which announce mergers or acquisitions and indulge in huge value acquisitions[40] demonstrate a greater desire to reduce tax. Gul et al.'s[41] study specifically focused on US-based firms. However, the results correspond with those undertaken in Europe, where a similar relationship had been examined and proven between mergers and acquisitions and the level of corporate tax paid.[42] Gul et al.[43] explain their findings on the basis of managerial opportunistic and efficiency motives by considering the characteristics of CEOs. Their research revealed how managerial acquisitiveness affects the desire to pay tax in the case of acquisitions, where managers base their decisions on self-interest and are opportunistically motivated.

Agency theory insists that the main focus of interest of the owners is the accumulation of wealth and higher financial gains, thus paying less tax is one way of doing that.[44] Under the proposition of this theory, the tax paid is correlated with the kind of ownership the firms have.[45] Agency theory is a management and economic theory which explains relationships and self-interest in organisations.[46] The theory highlights the relationship between the

[34] Michael Cooper and Matthew Knittel, 'Partial Loss Refundability: How Are Corporate Tax Losses Used?' (2006) 59(3) *National Tax Journal* 651.

[35] David T Brown and Michael D Ryngaert, 'The Mode of Acquisition in Takeovers: Taxes and Asymmetric Information' (1991) 46(2) *The Journal of Finance* 653.

[36] Merle Erickson and Shiing-wu Wang, 'Tax Benefits as a Source of Merger Premiums In Acquisitions of Private Corporations' (2007) 82(2) *The Accounting Review* 359.

[37] Alan Auerbach and David Reishus, *The Impact of Taxation on Mergers and Acquisitions* (NBER Chapters, National Bureau of Economic Research, Inc, 1987) 69 <https://econpapers.repec.org/bookchap/nbrnberch/5822.htm>.

[38] Harold Bierman, 'A Neglected Tax Incentive for Mergers' (1985) 14(2) *Financial Management* 29; Willard T Carleton, David K Guilkey, Robert S Harris and John F Stewart, 'An Empirical Analysis of the Role of the Medium of Exchange in Mergers' (1983) 38(3) *The Journal of Finance* 813.

[39] Ferdinand A Gul, Mehdi Khedmati and Syed MM Shams, 'Managerial Acquisitiveness and Corporate Tax Avoidance' (2020) 64 *Pacific-Basin Finance Journal* 101056.

[40] Note that the value shifting rules described in Divisions 725, 723 and 727 of the ITTAA 1997 are outside the scope of this study.

[41] Gul et al., (n 39).

[42] Daniel Duarte and Victor Barros, 'Corporate Tax Avoidance and Profitability Followed by Mergers and Acquisitions' (2018) 15(2–1) *Corporate Ownership and Control* 148.

[43] Gul et al., (n 39).

[44] Michael C Jensen and William H Meckling, 'Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure' (1976) 3(4) *Journal of Financial Economics* 305.

[45] Mark S Beasley, 'An Empirical Analysis of the Relation between the Board of Director Composition and Financial Statement Fraud' (1996) 71(4) *The Accounting Review* 443.

[46] Jensen and Meckling, (n 44).

various agents in a business; for instance, the role of management in satisfying the shareholders and, consequently, taking actions that bring economic benefits for the firm and the management itself.[47] The theory is also explained in terms of risk-sharing in businesses.[48]

The study by Gul et al.[49] also reveals that the said association is weaker in cases where acquiring firms receive higher quality audits, the management receives high equity-based compensation, and when the deals are regarded as a means to create value. Merger and acquisition deals are primarily signed on the basis of 'ownership advantages'.[50]

Ownership advantages occur when a change in firm ownership results in some form of value creation, such as an increase in cash flows or a decrease in risk.[51] The cash flow is often improved by adopting tax reduction strategies such as increasing tax shields due to acquiring accumulated losses that soak up the income, which is subject to tax.

The literature also highlights increased profitability by the acquiring firm.[52] Brailsford and Knights[53] explain that merger and acquisitions occur on the basis of synergies – (where two companies combine as a result of a merger and acquisition deal), their worth multiplies compared to their previous independent values. Takeovers can also cause synergetic advantages by reducing operational costs and consolidation, resulting in an increased market share and revenue growth.[54] While mergers and acquisitions generate operational and financial synergies, tax synergies may also largely impact the operations.[55]

Multiple datasets were collected by Auerbach and Reishus[56] pertaining to the years 1968-1983. On the contrary, they found that tax advantages were not one of the most prominent reasons behind the merger and acquisition transactions. They could only find 20% of the mergers having obvious potential tax advantages or reductions, such as the transfer of losses or credits. The total value of taxes they estimated was only 10% of the target's market value, a percentage way below the acquisition premiums. However, it is important to note that their merger sample ended before financing acquisitions by debt became an important feature of takeovers during the mid-1980s.

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[47] Mark D Schroeder, Christina Greer and Ulrike Gaul, 'How to Make Stripes: Deciphering the Transition from Non-Periodic to Periodic Patterns in *Drosophila* Segmentation' (2011) 138(14) *Development* 3067.

[48] Catherine M Daily, Dan R Dalton and Albert A Cannella, 'Corporate Governance: Decades of Dialogue and Data' (2003) 28(3) *The Academy of Management Review* 371.

[49] Gul et al., (n 39).

[50] Klassen and Laplante, (n 23) 1245.

[51] Ibid.

[52] Paul A Pautler, 'Evidence on Mergers and Acquisitions' (2003) 48 *Antitrust Bulletin* 119.

[53] Timothy J Brailsford and Stephen Knights, *The Financial and Non-Financial Effects of Corporate Takeovers* (1998), Parkville, Melbourne Institute of Applied Economics and Social Research, The University of Melbourne.

[54] Puspita Rani, Elvia R Shauki, Darminto and Ruslan Prijadi, 'Motives, Governance, and Long-Term Performance of Mergers and Acquisitions in Asia', ed Collins G Ntim (2020) 7(1) *Cogent Business & Management* 1791445.

[55] Marina Martynova and Luc Renneboog, 'A Century of Corporate Takeovers: What Have We Learned and Where Do We Stand?' (2008) 32(10) *Journal of Banking & Finance* 2148.

[56] Auerbach and Reishus, (n 37).

Different results were produced in studies that consider the high debt load in observing the tax effects. Kaplan and Strömberg[57] found that in cases where the returns to public shareholders were high, they were related to tax savings from a new capital structure. The estimated tax savings formed the basis of explaining most of the premium. In this regard, the findings of Schipper and Smith[58] are virtually identical. They also found a significant relationship between tax advantages and the payment of dividends to shareholders. Additionally, empirical evidence reveals a positive correlation between high market capitalisation firms engaging in merger and acquisition deals and an increase in dividends.[59]

The literature reveals that the deregulation in economic conditions may lead firms to consider merger and acquisition deals for financial gains. The impact of tax motives cannot be ignored here as it plays a vital role in financial synergy. Gilson, Scholes and Wolfson[60] explain a relationship between merger and acquisition activities and tax advantages based on a certain percentage of mergers and acquisitions that they investigated. On the other hand, other studies reveal that potential tax advantages or reductions stem from net operating loss carry-forwards and shared tax credits.[61] Further studies have revealed that positive anomalous returns during the pre-bid period are consistent with the premise that enterprises that do exceptionally well and have excess capital to invest, view takeovers as a lucrative way to invest those funds.[62]

Economic Deterrence Theory sheds light on the importance of economic incentives in decision making. A number of other economic-based theories also propose a similar phenomenon. Milliron and Toy[63] explain that taxpayers use cost-benefit analysis for compliance decisions. According to economic deterrence theory, firms are utility maximisers influenced by economic benefits such as tax advantages. Therefore, when firms find that their tax advantages can increase as a result of a merger and acquisition deal, they may be motivated to undertake such transactions. On the other hand, regret theory suggests that ‘utility associated with any consequence of choice under uncertainty is not simply a function of the consequence itself, but may depend upon the consequence(s) of the other unchosen action(s) under the same state of the world.’[64] Hence, a firm’s decision regarding a merger and acquisition deal may not only be based on the expectation of increased tax advantages or

[57] Steven N Kaplan and Per Strömberg, ‘Financial Contracting Theory Meets the Real World: An Empirical Analysis of Venture Capital Contracts’ (2003) 70(2) *Review of Economic Studies* 281.

[58] Katharine Schipper and Abbie Smith, Corporate income tax effects of management buyouts, (1988) Working paper (University of Chicago, Chicago, IL).

[59] Sydney Finkelstein and Cary L Cooper (eds), *Advances in Mergers and Acquisitions: Volume 17* (Emerald Publishing Limited, 2018).

[60] Ronald J. Gilson, Myron S. Scholes and Mark A. Wolfson, Taxation and the Dynamics of Corporate Control: The Uncertain Case for Tax Motivated Acquisitions, in, Knights, Raiders, and Targets, The Impact of the Hostile Takeover. John C. Coffee, Jr., Louis Lowenstein, Susan Rose-Ackerman, editors. New York, NY: Oxford University Press, 1988.

[61] See Carla Hayn, ‘Tax Attributes as Determinants of Shareholder Gains in Corporate Acquisitions’ (1989) 23(1) *Journal of Financial Economics* 121; Eric Ohrn and Nathan Seegert, ‘The Impact of Investor-Level Taxation on Mergers and Acquisitions’ (2019) 177 *Journal of Public Economics* 104038.

[62] Raymond da Silva Rosa and Terry Walter, ‘Australian Mergers and Acquisitions Since the 1980s: What Do We Know and What Remains to Be Done?’ (2004) 29(1) *Australian Journal of Management* i.

[63] Valerie C Milliron and Daniel R Toy, ‘Tax compliance: An investigation of key features’ (1988) 9 *The Journal of the American Tax Association* 84.

[64] Graham Loomes, ‘Preference Reversal: Explanations, Evidence and Implications’ (1990) 23(1) *Annals of Operations Research* 65.

a reduction in taxes but also to avoid a situation in which they may face an increased tax burden.

Rational Choice Theory proposes that taxpayers make analytical calculations to reach logical outcomes and achieve goals in line with their objectives. Studies reveal that in most cases, the goals are associated with maximising self-interest.[65] The use of rational choice theory provides taxpayers benefits and satisfaction in being able to increase their wealth and reduce taxes. This rationale aligns with the economic deterrence theory, which assumes that taxpayers are ‘profit seeking’.[66] Consequently, taxpayers apply economic rationale and choose the course of action that benefits them.

The determinants of corporate tax inversions[67] were studied by Desai and Hines.[68] In their study, they found that large and more leveraged corporations were more inclined to invert. However, they failed to find out if the leverage increases after mergers and acquisitions. It should be noted that inversions are an American structuring device that may not apply in the typical Australian setting. A further study conducted by Ghosh and Jain[69] provided solid empirical evidence that showed a high level of financial leverage following merger and acquisition deals. In contrast, Graham and Tucker[70] concluded that firms involved in tax shields have lower debt ratios and higher market capitalisation.

In most cases, the focus on increasing profitability results in opposing tax behaviours.[71] Firms with higher profits can better disguise their understated income without being scrutinised by tax authorities. On the other hand, firms with decreased profits are pressured to indulge in tax minimisation strategies to obtain approved standards and reach targets by increasing pre-tax earnings or decreasing tax expenses.[72] Other research has indicated that the main incentive for reducing taxes is simply to increase profits.[73]

Another recent study employed a sample of 243 completed merger and acquisition deals in South Korea to assist in understanding the motivations behind those deals.[74] It was found

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[65] Sarah Lichtenstein and Paul Slovic, ‘Reversals of Preference between Bids and Choices in Gambling Decisions.’ (1971) 89(1) *Journal of Experimental Psychology* 46.

[66] Ojochogwu Winnie Atawodi and Stephen Aanu Ojeka, ‘Factors That Affect Tax Compliance among Small and Medium Enterprises (SMEs) in North Central Nigeria’ (2012) 7(12) *International Journal of Business and Management*, 87.

[67] In Mihir A Desai and James R Hines, ‘Expectations and Expatriations: Tracing the Causes and Consequences of Corporate Inversions’ (2002) 55(3) *National Tax Journal* 409 ‘Tax inversions refer to restructuring of corporations by replacing the existing parent by a foreign parent, to gain tax advantages’.

[68] (Desai and Hines n 67).

[69] Aloke Ghosh and Prem C Jain, ‘Financial Leverage Changes Associated with Corporate Mergers’ (2000) 6(4) *Journal of Corporate Finance* 377.

[70] John R Graham and Alan L Tucker, ‘Tax Shelters and Corporate Debt Policy’ (2006) 81(3) *Journal of Financial Economics* 563.

[71] Eric M Rice, *The Corporate Tax Gap: Evidence on Tax Compliance by Small Corporations* (1990) University of Michigan Press.

[72] Shumi Akhtar, Farida Akhtar, Kose John and Su-Wen Wong, ‘Multinationals’ Tax Evasion: A Financial and Governance Perspective’ (2019) 57 *Journal of Corporate Finance* 35.

[73] Amy Dunbar, Danielle M Higgins, John D Phillips and George A Plesko, ‘What do measures of tax aggressiveness measure?’ (2010) 103 *Proceedings of the National Tax Association Annual Conference on Taxation* 18.

[74] Joohyun Lim, ‘Tax Avoidance and M&A’ (2020) 5(3) *Research in Economics and Management* 142.

that merger and acquisition deals are regarded as a profit-maximising opportunity and were common in high market capitalisation firms with the potential to invest in such deals.

Belz et al.[75] studied the comparison and change in a target's effective tax rate prior to the deal and after the deal and found nearly a 3% reduction in payment of taxes after the deal. However, the analysis was conducted on European firms only and focused on higher market capitalisation firms. This study is differentiated in that it considers firms with high, medium, and low market capitalisation to investigate how market size may impact tax payments in Australia.

Consequently, the current literature indicates that taxation may be one of the reasons that influence management to engage in merger and acquisition deals, as some may view these deals as a means for obtaining tax advantages. Other possible tax advantages that a firm can obtain through merger and acquisition operations may include the elimination of inheritance taxes achieved by selling off the firm and tax-deductible interest payments on loans.[76] Recapitalisation also produces other tax advantages. In cases where the target firm has operating tax losses, the losses are often transferred to the acquirer to reduce tax liabilities.[77] Consequently, when the taxable income of the acquirer is offset, it allows them to reduce the effective amount of tax payable.[78]

C *Cross-Border Deals and International Tax Advantages*

A number of studies indicate that in some cases, firms also relocate their headquarters to reduce their tax burden.[79] Alba, Park and Wang[80] explain that a merger and acquisition involving at least two firms from different countries qualify as a cross-border merger and acquisition. Shimizu et al.[81] further elaborate that a cross-border acquisition happens

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[75] Thomas Belz, Leslie Robinson, Martin Ruf and Christian Steffens, 'Tax avoidance as a driver of mergers and acquisitions' (2013) *SSRN Electronic Journal* <http://www.ssrn.com/abstract=2371706>.

[76] Fred M McDougall and David Keith Round (eds), *The Effects of Mergers & Takeovers in Australia: A Research Study*, Information Australia for the Australian Institute of Management – Victoria (1986).

[77] Auerbach and Reishus, (n 37) 69 <https://econpapers.repec.org/bookchap/nbrnberch/5822.htm>; Ohrn and Seegert, (n 61) 104038.

[78] Ohrn, and Seegert, (n 61).

[79] See corporate tax inversions discussed previously (e.g. Johannes Voget, 'Relocation of Headquarters and International Taxation' (2011) 95(9–10) *Journal of Public Economics* 1067; Joseph A Clougherty, Jin Uk Kim, Bradley R Skousen and Florian Szücs, 'The Foundations of International Business: Cross-Border Investment Activity and the Balance between Market-Power and Efficiency Effects: The Foundations of International Business' (2017) 54(3) *Journal of Management Studies* 340; Mike Geppert, Christoph Dörrenbächer, Ian Taplin, Jens Gammelgaard, 'Managerial Risk-Taking in International Acquisitions in the Brewery Industry: Institutional and Ownership Influences Compared: Managerial Risk-Taking in Brewery Industry' (2013) 24(3) *British Journal of Management* 316.

[80] Joseph D Alba, Donghyun Park and Peiming Wang, 'Corporate Governance and Merger and Acquisition (M&A) FDI: Firm-Level Evidence from Japanese FDI into the US' (2009) 19(1) *Journal of Multinational Financial Management* 1.

[81] Katsuhiko Shimizu, Michael Hitt, Deepa Vaidyanath and Vincenzo Pisano, 'Theoretical Foundations of Cross-Border Mergers and Acquisitions: A Review of Current Research and Recommendations for the Future' (2004) 10(3) *Journal of International Management* 307.

between an 'acquired' firm and a 'target' firm with headquarters located in different countries.

There are mainly two types of transactions in cross-border deals, namely, inward and outward.[82] Hitt and Pisano[83] explain that when a foreign firm acquires a local firm, a host country receives direct investment and this kind of cross-border acquisition is categorised as inward acquisition. They further explain that a cross-border outward acquisition is where a local company acquires a firm based in a foreign country resulting in investment outflow. Studies emphasise that cross-border merger and acquisition deals are costlier than domestic deals due to the higher cost of legal fees and other related expenses.[84]

Voget[85] examined 140 multinational corporations and found that about 6% of firms were involved in cross-border mobility each year. He concluded that additional tax due with respect to repatriation of foreign profits and dividend repatriation tax in the home country was positively correlated to headquarter relocation. Further, he concluded that taxation of shareholders and personal income taxes also play a role in a firm's decision to relocate its headquarters.[86] Contrary to this, Blonigen and Davies[87] investigated US-based firms and emphasised that bilateral tax treaties, which reduce double taxation, have no significant effect on Foreign direct investment (FDI) activity. Another study, by Becker and Fuest,[88] asserted that obtaining tax advantages was one of the reasons behind the cross-border acquisition. The study proved that tax advantages or reductions are likely to be gained when an acquiring firm in a high corporate tax country establishes an affiliate in a low tax country. This could also have implications for merger and acquisition deals in Australia.

Huizinga and Voget[89] asserted that amendments in tax laws and changes in tariffs also significantly influence a firm's decision regarding overseas acquisitions. Similarly, Becker and Fuest[90] found that an increase in local corporate tax rates could increase the likelihood of domestic firms investing in countries with lower corporate tax rates. Becker and Fuest[91] further noted that double taxation results in the form of non-resident dividend withholding taxes, and the parent country's corporate income tax on repatriated dividends, meant that countries that levy higher overseas double taxation are less attractive to the parent firms of newly established multinational enterprises.

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[82] Michael A Hitt and Vincenzo Pisano, 'The Cross-Border Merger and Acquisition Strategy: A Research Perspective' (2003) 1(2) *Management Research: Journal of the Iberoamerican Academy of Management* 133.
[83] Ibid.
[84] For example Arturo Bris and Christos Cabolis, 'The Value of Investor Protection: Firm Evidence from Cross-Border Mergers' (2008) 21(2) *Review of Financial Studies* 605; Yenn-Ru Chen, Yu-Lin Huang and Chun-Nan Chen, 'Financing Constraints, Ownership Control, and Cross-Border M&As: Evidence from Nine East Asian Economies' (2009) 17(6) *Corporate Governance: An International Review* 665; Dutta, Malhotra, & Zhu, 2016.
[85] Johannes Voget, 'Relocation of Headquarters and International Taxation' (2011) 95(9–10) *Journal of Public Economics* 1067.
[86] Ibid.
[87] Bruce A Blonigen and Ronald B Davies, 'The Effects of Bilateral Tax Treaties on U.S. FDI Activity' (2004) 11(5) *International Tax and Public Finance* 601.
[88] Johannes Becker and Clemens Fuest, 'Taxing foreign profits with international mergers and acquisitions' (2010) 51(1) *International Economic Review* 171.
[89] Harry P Huizinga and Johannes Voget, 'International Taxation and the Direction and Volume of Cross-Border M&As' (2009) 64(3) *The Journal of Finance* 1217.
[90] Becker and Fuest, (n 8) 28.
[91] Ibid.

Further studies reveal that macro-economic conditions also play a significant role in the firm's decision to adopt favourable tax strategies.[92] In this regard, it is important to examine corporate tax behaviour during a crisis. It is believed that Australia's performance during the Global Financial Crisis of 2007-08 was better than the US and other developed economies, including the European Union.[93]

However, Australia experienced the effects of the budget deficit and a reduction in interest rates.[94] Consequently, there was a sharp decline in the stock market and some large corporations, such as Babcock and Brown, Timber corp., and Great Southern witnessed bankruptcy.[95] As a result of the crisis, many Australian-based firms also became insolvent.

As experienced during the financial crises, macro-economic conditions resulted in businesses struggling to maintain their cash flows and solvency position.[96] As a result, management considered possible tax minimisation measures to maintain cash flow. Edwards, Schwab and Shevlin[97] explain that during financial crises, the managerial decisions regarding merger and acquisition deals are triggered by their instinct to survive. They further explain that survival is often based on minimising taxes to maintain cash flow and solvency.

D *The Influence of Managerial Power upon Merger and Acquisition Deals*

Prior studies further confirm that one of the significant ways firms benefit from tax minimisation is through increased tax savings, leading to an increase in cash flow.[98] In addition, several studies also reveal that senior management involved in the decision-making process of firms may influence the level of tax minimisation in their firms. As companies use performance indicators to determine incentives for executives, management is inclined to reduce taxes where possible with the motive of improving the company's performance.[99]

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92 Anthony Klan 2013, '*Company failures hit record high'*, The Australian, <http://www.theaustralian.com.au/business/companies/company-failures-hit-record-high/story-fn91v9q3-1226582255301>.

93 Ibid.

94 Robert W Kolb (ed.), *Lessons from the Financial Crisis: Causes, Consequences, and Our Economic Future.* 1st edn, John Wiley & Sons.

95 Anthony Klan 2013 (n 92).

96 John Brodonlo 2009,'*Collecting taxes during an economic crisis: challenges and policy options'*, IMF Staff Position Note, SPN/09/17 (14 July 2009) <https://www.imf.org/external/pubs/ft/spn/2009/spn0917.pdf>.

97 Alexander S Edwards, Casey Schwab and Terry J Shevlin, 'Financial Constraints and the Incentive for Tax Planning' [2012] *SSRN Electronic Journal* <http://www.ssrn.com/abstract=2163766>.

98 For example see Shuping Chen, Xia Chen, Qiang Cheng and Terry Shevlin, 'Are Family Firms More Tax Aggressive than Non-Family Firms?' (2010) 95(1) *Journal of Financial Economics* 41; John R Graham, Michelle Hanlon, Terry Shevlin and Nemit Shroff, 'Incentives for Tax Planning and Avoidance: Evidence from the Field' (2014) 89(3) *The Accounting Review* 991; Amilcar Armando Menichini, 'On the Value and Determinants of the Interest Tax Shields' [2014] *SSRN Electronic Journal* <http://www.ssrn.com/abstract=2499835>; Ling Cen, Edward L Maydew, Liandong Zhang and Luo Zuo, 'Customer–Supplier Relationships and Corporate Tax Avoidance' (2017) 123(2) *Journal of Financial Economics* 377.

99 John D Phillips, 'Corporate Tax-Planning Effectiveness: The Role of Compensation-Based Incentives' (2003) 78(3) *The Accounting Review* 847.

Consequently, when executives receive fewer monetary gains, they may undertake transactions driven by self-interest, such as signing merger and acquisition deals that can then result in tax advantages for the corporation and, thereby, increase monetary benefits for themselves.[100]

Brailsford and Knights[101] found that merger and acquisition deals offer managers incentives to acquire firms to seek control of target firms, which, in most cases, are low market capitalisation firms. Jensen and Meckling[102] explain that takeovers work as mechanisms to control externalities that restrict managerial actions from neglecting the aim of maximising shareholder wealth. Various other studies also reveal that increasing shareholder value often influences management to consider minimising taxes.[103]

The above findings support the Upper Echelon Theory, which indicates that firms reflect the mindset of their top management, and the corporate strategies, thereof, are deeply influenced by managers and their personal attributes.[104] Hence, according to the central premise of this theory, if the senior management views all opportunities, alternatives, and threats through their own personal lenses, they are likely to accept deals or offers that benefit them in more than one way.[105] As such, merger and acquisition deals may be signed to benefit firms and shareholders, which may involve gaining deliberate tax advantages.[106]

Upper Echelon Theory explains that every corporate strategy reflects the values, personalities and motives of management.[107] This can be explained through a simple example such as, while some firms may indulge in merger and acquisition deals once every few years, others may do it more frequently. The reoccurrence of such deals for management may explain their behaviour or motives of potentially growing their financial worth. However, for the purpose of this study, the aspect of managerial behaviour and mindset is not directly examined. Managerial psychology sheds light on the efficacy of individual managers' psyche through studying their behaviour patterns. Although it is acknowledged as an essential aspect of decision-making, it is outside the scope of this present study.

When merger and acquisition decisions are implemented by management, it can be expected that managers are acting in the best interest of the shareholder to maximise shareholder wealth. Similarly, the firm's strategy would be to reduce corporate tax obligations that then benefit the shareholder.[108] Arguably, managers who implement merger and acquisition deals

[100] Fabio B Gaertner, 'CEO After-Tax Compensation Incentives and Corporate Tax Avoidance' (2014) 31(4) *Contemporary Accounting Research* 1077.

[101] Brailsford and Knights, (n 53).

[102] Michael C Jensen and William H Meckling, 'The market for corporate control: The scientific evidence'(1983) 11(4) *Journal of Financial Economics* 5.

[103] For example see Shuping Chen, Xia Chen, Qiang Cheng and Terry Shevlin, 'Are Family Firms More Tax Aggressive than Non-Family Firms?' (2010) 95(1) *Journal of Financial Economics* 41; Fabio B Gaertner, (n 101) 1077.

[104] Donald C Hambrick and Phyllis A Mason, 'Upper Echelons: The Organization as a Reflection of Its Top Managers' (1984) 9(2) *The Academy of Management Review* 193.

[105] Ibid.

[106] Andrew Bartlett and David Preston, 'Can Ethical Behaviour Really Exist in Business?' (2000) 23(2) *Journal of Business Ethics* 199.

[107] Hambrick and Mason, (n 104) 193.

[108] Phillips, (n 100) 847; John R Robinson, Stephanie A Sikes and Connie D Weaver, 'Performance Measurement of Corporate Tax Departments' (2010) 85(3) *The Accounting Review* 1035.

for value-creation for shareholders may also engage in tax minimisation and accumulate large cash balances and resources to create value for the firm.[109] This incentive to increase their corporate wealth may be directly affiliated with managerial opportunistic tax minimisation strategies, which aim to extract revenue[110] and again demonstrates the influence of managerial power upon merger and acquisition deals.

Overall, based on the review of the literature, there is strong evidence that suggests that potential tax advantages and reductions can be derived through merger and acquisition deals. Consequently, this study tests the following hypothesis:

H1: Australian acquirer firms with higher market capitalisation gain significant tax advantages through merger and acquisition deals

III RESEARCH METHOD

A quantitative research approach was adopted for this study which drew a comparison between figures from pre- and post-merger and acquisition periods employing secondary source data. This study then applied appropriate correlation statistical testing techniques to the data. The statistical tests examined multiple variables to indicate their relationship if any. Specifically, the research aim was to find whether there was an association between potential tax advantages, as identified in a number of ways and merger and acquisition deals.

It is important to acknowledge that this study does not evaluate any causation principle but rather the correlation evident between variables at varied points in time (before and after the merger and acquisition deals). The study takes a deductive approach towards the research. Employing secondary source data from authentic sources made this approach the most suitable for this particular study.[111] Employing secondary data also provided cost-efficiencies and time-saving attributes.[112]

A *Sample Selection and Data Collection*

The initial sample comprised all Australian merger and acquisition deals completed between 2000 and 2019. Australian mergers and acquisitions, in this study, are mainly defined as the deals in which both the acquirer and the target firms are Australian-based. The study sample was collected from the database of Morning Star.[113] However, the final sample was

[109] Mihir A Desai, Alexander Dyck and Luigi Zingales, ‘Theft and Taxes’ (2007) 84(3) *Journal of Financial Economics* 591; Bartlett and Preston, (n 106) 199.

[110] Ohrn and Seegert, (n 61) 104038.

[111] Morning Star and Thomson Reuters.

[112] Jane Frecknall-Hughes, ‘Research Methods in Taxation History’ (2016) 3(1) *Review of Behavioral Economics* 5.

[113] Morning Star is an Australian-based database providing financial data of all Australian firms by using independent research, ratings and tools (Morning Star 2019).

narrowed down to include only those deals which were completed between 2005 and 2015. This was done to increase comparability between periods. For the sake of comparison, the study evaluates five years of data prior to the deal and five years following the deal. Hence, although the deals pertain to years between 2005 and 2015, the financial data pertains to years between 2000 and 2019 to cover five years, pre- and post-merger and acquisition deals.

Although, there has been a considerable increase in merger and acquisition deals during the past four to five years in Australia, this study was deliberately based on a comparison of observations between 2005-2015. As such, the findings relate to this period only.[114] Although the initial sample identified 179 deals, the final sample used in the study consisted of 97 observations which included firms of various sizes.

Financial data for the identified deals were collected from the databases of Morning Star and Thomson Reuters Australia,[115] and the financial statements of the acquirer and target firms between the period 2000 and 2019, available on their respective websites. After the data collection, the two databases (list of merger and acquisition deals and the financial data pertaining to the firms) were merged to associate each deal with its financial data. For the merger and acquisition process, only one deal of each acquirer and target firm was included in the sample. The initial sample was further narrowed down due to the restricted disclosure of financial data. The only firms kept in the analysis were those labelled as active for the entire observation period. All ownership percentages and forms of acquisitions were considered to cover a wide range of mergers and acquisitions, including; mergers, takeovers, acquisitions, schemes of arrangements, scheme implementations and consolidations.

[114] David Heathcote, 'Australia's Evolving Deals Landscape: 2018 Survey Report - KPMG Australia', *KPMG* (2 August 2021) <https://home.kpmg/au/en/home/insights/2018/08/australia-evolving-deals-landscape-survey-report.html>.

[115] Thomson Reuters Australia is a database providing financial data for businesses and professionals (Thomson Reuters Australia 2019).

B *Variables Investigated*

The tax literature introduces a variety of measures that depict corporate tax benefits and advantages. These measures indicate the amount and type of tax advantage generated by firms.[116] The variables are listed and defined below in Table 1:

Table 1 Definition of variables

Variables	Represented by	Definition
Book Effective Tax Rate	- **BETR**[117]	Tax expense divided by earnings before taxes (pre-tax accounting income)
Cash Effective Tax Rate	- **CETR** Cash tax paid divided by earnings before taxes	Cash tax paid divided by earnings before taxes (pre-tax accounting income)
Tax Shields	– **TXSH**	A means to minimise a firm's taxable income and, therefore, tax liability
Number of Deals	**- NoD**	The number of deals during the period of observation
Value of Deals	**- DVALUE**	The total dollar value of deals
Global Financial Crisis	**- GFC**	The period in which the deal was completed; before or after the GFC
Dividends	**- DIV**	Payments to shareholders (as a distribution out of profits)
Market capitalisation	**Mkt. Cap*. -**	Total dollar market value of a firm's outstanding shares

*Dependent variable

The existing literature refers to a number of measures as gauging tax advantages. However, effective tax rates are considered the most useful as they are widely available and easily

[116] Clive Lennox, Petro Lisowsky and Jeffrey Pittman, 'Tax Aggressiveness and Accounting Fraud' (2013) 51(4) *Journal of Accounting Research* 739.

[117] To calculate the BETR for each firm in each year of study, values of 'tax expense' and 'earnings before taxes' were collected from the databases and saved in excel, the two values were then divided to obtain values for book ETR. Further, to evaluate the changes in book ETR over the years, the values were coded as '1' and '0' before running through SPSS; '0' representing a decrease in book ETR after the deal, and '1' representing an increase in the book ETR after the deal.

comparable.[118] Effective tax rates are also useful in measuring a company's tax position because they reflect tax liability more accurately than marginal tax rates.[119] Thus, one of the significant variables to measure tax advantages include effective tax rates. The effective tax rate is defined as the average rate at which a company is taxed on pre-tax profits. It is the ratio of total tax expenses to earnings before income tax (EBIT) or pre-tax accounting income. The higher the ETR of the firm, the less is the desirability for reducing taxes. A variation of annual ETR is the Cash Effective Tax Rate (CETR), the ratio of cash taxes paid to earnings before income tax.

A further measure employed in gauging corporate tax advantages used in various studies is Tax Shields.[120] Tax Shields are tax shelters or tax benefits that can comprise, for example, the utilisation of carried forward losses and depreciation deductions. Tax Shield figures were calculated from the figures found in the financial statements of the firms.[121] Using Tax Shields to reduce taxes is considered to be one of the more aggressive forms of tax minimisation.[122] This study considered the values of Tax Shields used by the firms before and after the merger and acquisition deals. Furthermore, the numbers of deals the firms have been involved in for the given period were also analysed.

Gul et al.[123] use Deal Value to determine the level of managerial acquisitiveness, which they explain as the management's motive to reduce taxes. However, in this study, the variable is used to examine if any association exists between the firms' merger and acquisition decisions and tax advantages associated with the deals. This value is defined as the total dollar value of the deal.[124] To conduct statistical analysis, the values were separated into two groups by the median. In addition, the frequency with which the sample firms sign merger and acquisition deals has also been taken into consideration to study the level of motivation.

While changes in dividends may not directly imply an association between a reduction in taxes and the merger and acquisition deals, it is considered a relevant variable in the tax literature.[125] An increase in dividends indicates increased profits, and retaining profits is also commonly used as a tax reduction measure.[126]

In addition, Market Capitalisation is an indicator of the size of the firm. Details of the market capitalisation of each firm were obtained – the year 2010 was taken as the base year for this variable. This was appropriate given that the majority of the merger and acquisition deals in

[118] Christopher S Armstrong, Jennifer L Blouin and David F Larcker, 'The Incentives for Tax Planning' (2012) 53(1–2) *Journal of Accounting and Economics* 391.

[119] Thomas R Kubick, Daniel P Lynch, Michael A Mayberry and Thomas C Omer, 'Product Market Power and Tax Avoidance: Market Leaders, Mimicking Strategies, and Stock Returns' (2015) 90(2) *The Accounting Review* 675.

[120] Armstrong et al., (n 118) 391.

[121] Tax shields were obtained by adding the various tax-deductible expenses and then multiplying the result by the applicable tax rates.

[122] Lennox et al., (n 116) 739.

[123] Gul et al., (n 39) 01056.

[124] Michael Dowling and Zakaria Ali Aribi, 'Female Directors and UK Company Acquisitiveness' (2013) 29 *International Review of Financial Analysis* 79.

[125] Kubick et al., (n 119) 675.

[126] Dowling and Ali Aribi, (n 124) 79.

the sample took place in 2010. It also forms the mid-point of the sample (taken between 2005 to 2015).

The data was coded by grouping the companies based on their Market Capitalisation. To achieve this, two groups were formed. Further, the Global Financial Crisis of 2007-08 has also been employed as a variable to examine the nature of corporate behaviour in potentially seeking tax advantages during the environment of a financial crisis. Examining the correlation between the financial distress of a company and the potential tax advantages gained, if any, was carried out by observing the timing of the deals and whether or not the Global Financial Crisis increased or decreased the firm's interest to engage in merger and acquisition deals. This may also have implications in the current Covid-19 environment, where economic conditions have been severely impacted.

VI DISCUSSION AND ANALYSIS OF THE EMPIRICAL RESULTS

A *Descriptive Statistics*

The descriptive analysis of the variables, including their percentages, standard deviations and means, is provided below in Table 2.

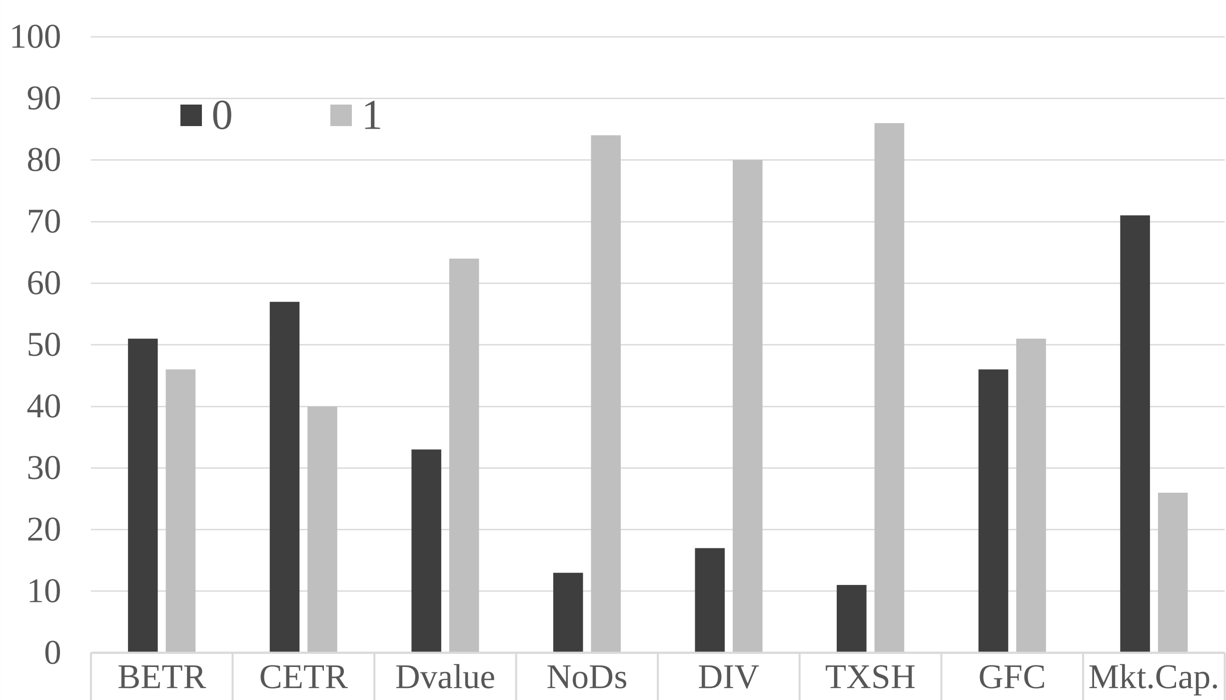
Table 2 Descriptive Statistics

Variables	Mean	Std dev	Min	Max
BETR	.47	.502	0	1
CETR	.41	.492	0	1
TXSH	.89	.319	0	1
NoD	3.84	1.847	1	7
DVALUE	.659	.476	0	1
GFC	.525	.501	0	1
DIV	.824	.382	0	1
Mkt Cap	.27	.445	0	1

As illustrated in the table above, the mean for BETR stands at 0.47, while CETR at 0.41. The mean for Deal Value is calculated at 0.659, and the standard deviation is at 0.476. The variable has been included to examine the corporate strategy of firms and their motivation if any, to reduce taxes. Furthermore, the Number of Deals the sample firms were involved in during the respective periods of the study has a minimum range of 1 deal in the ten years in question, whereas the maximum is 7 deals during this period.

The mean is calculated to be 3.84, and the standard deviation is 1.847, as shown above. The mean noted for Dividends is 0.824 and the standard deviation 0.382. In 11 cases (11.3%), the value of Tax Shields decreased after the deal, thus, implying a decrease in tax benefits obtained. However, in the case of 86 firms (88.7%), an increase in the value of Tax Shields after the merger and acquisition deals was noted. The figures indicate that most of the deals, 51 (52.6%), were completed after the crisis. The mean is calculated as 0.525 and the standard deviation as 0.501.

Table 3 Movement in the variables post-merger and acquisition deals



	BETR	CETR	Dvalue	NoDs	DIV	TXSH	GFC	Mkt.Cap.
0	51	57	33	13	17	11	46	71
1	46	40	64	84	80	86	51	26

Firms showing a decrease in variables (in years following the deals)

Firms showing an increase in variables (in years following the deals) (see also Fig 1 Appendix)

The Book Effective Tax Rates of 97 firms in the sample were collected for a total number of 10 years, five years prior to the deals, and five years following the deals. Results in Table 3 show 51 firms (52.6%) saw a decrease in their Book Effective Tax Rates after the deals, suggesting a possible association with an increase in the level of tax advantages derived. In addition, it was also observed that 46 firms (47.4%) had an increase in their Book Effective Tax Rates, showing a potential decrease in the level of tax advantages gained. Results show that 57 firms (68%) had a reduction in their Cash Effective Tax Rates following the deals, suggesting a possible increase in the level of tax advantages gained. It should also be noted that in 40 cases, the Cash Effective Tax Rate increased, indicating a potential decrease in the level of tax advantages gained.

Further in Table 3, the increase in 'dividends' was present in 80 firms (82.5%). In contrast, only 17 firms (17.5%) show a decrease in dividend payments following the deals with a mean of 0.82 and a standard deviation of 0.382. The figures also show that in 11 cases (11.3%), the value of the tax shield decreased after the deal, indicating a potential decrease in tax advantages obtained. However, in the case of 86 firms (88.7%), there was an increase in the value of tax shields and potential tax advantage after the merger and acquisition deal. Table 3 also indicates that 46 (47.4%) of the deals in the sample were made before the financial crisis of 2007-08. The sample contained 71 small and medium-sized market capitalisation firms, while 26 firms comprised high Market Capitalisation.

Deal Values were divided into two groups: those where the deals' values were below or equal to 500 million and those where the values were above 500 million (AUD). It was noted that 33 companies (34%) invested between 1 million to 500 million in each merger and acquisition deal. However, 64 deals (66%) invested less than this. The variable has been included to examine whether the deal's value has resulted in less tax being paid. The majority of firms completed 3 deals during the period of observation, as 20 firms (20.6%) signed 3 deals. This was followed closely by 4 deals signed by 16 firms and 6 deals signed by 15 firms. The maximum number of deals, of 7, was signed by 8 firms. This variable may assist in understanding the reasons why management engages in multiple merger and acquisition deals.

B *Correlation Analysis*

Correlation analysis was employed to identify and explain possible relationships between the variables and test the hypothesis. Results are displayed in Table 4 below.

Table 4 Correlation Matrix

Correlations									
		BETR	**CETR**	**DValue**	**NoD**	**MktCap**	**DIV**	**TXSH**	**GFC**
BETR	Pearson Corr	1	.127	.028	.018	.124	.003	.209*	.034
	Sig.		.215	.783	.862	.225	.974	.040	.743
CETR	Pearson Corr	.127	1	-.017	.052	.013	-.165	.035	-.127
	Sig.	.215		.866	.610	.898	.107	.731	.215
DValue	Pearson Corr	.028	-.017	1	.480**	.435**	.070	.155	.146
	Sig.	.783	.866		.000	.000	.498	.130	.154
NoD	Pearson Corr	.018	.052	.480**	1	.612**	.210*	.145	-.119
	Sig.	.862	.610	.000		.000	.039	.157	.246
MktCap	Pearson Corr	.124	.013	.435**	.612**	1	.218*	.216*	-.031
	Sig.	.225	.898	.000	.000		.032	.033	.761
DIV	Pearson Corr	.003	-.165	.070	.210*	.218*	1	.177	.051
	Sig.	.974	.107	.498	.039	.032		.082	.620
TXSH	Pearson Corr	.209*	.035	.155	.145	.216*	.177	1	-.144
	Sig.	.040	.731	.130	.157	.033	.082		.158
GFC	Pearson Corr	.034	-.127	.146	-.119	-.031	.051	-.144	1
	Sig.	.743	.215	.154	.246	.761	.620	.158	

*. Correlation is significant at the 0.05 level (2-tailed).

**. Correlation is significant at the 0.01 level (2-tailed).

Note: The table above shows intercorrelations among variables. N= 97.

In Table 4 the Pearson correlation coefficient between Market Capitalisation and Tax Shields is calculated at 0.216 and has a p-value of 0.033, which is significant. The association indicates a positive correlation between the two variables. Consequently, as Market Capitalisation increases, so does the value of Tax Shields (e.g. utilising carry-forward losses). Tax Shields is one of the main variables being tested in the study that potentially represents a tax advantage. Hence, the analysis indicates that the greater the firm size, the greater the Tax Shields (tax advantage) used by the merger and acquisition firms. Likewise, a higher level of tax minimisation can be associated with higher market capitalisation. It indicates that Tax Shields significantly grow as merger and acquisition deals are signed, and this increase is more prominent in larger firms. This is consistent with prior research that has shown that mergers and acquisitions are motivated by a desire to seek a tax advantage.[127]

[127] Klassen and Laplante (n23) 1245; Ohrn and Seegert, (n 61) 104038.

While making decisions regarding merger and acquisition deals, the management of the firms is generally interested in the other firm's financial characteristics and history that could provide potential tax advantages. This result aligns with Brailsford and Knights' findings[128] that concluded that companies are merged or acquired on the basis of tax synergies (i.e. interaction or cooperation of two or more organisations, to produce a combined effect greater than the sum of their separate effects). The more the acquiring firm can benefit from combining with the target firm, the higher will be the synergistic value. It should be noted that synergistic value is one of many factors that can influence mergers and acquisitions, and indeed each situation is somewhat unique. As established in section 2 of the paper, the theories that support the notion of management being all-powerful in making decisions that benefit them, in the long run, might be why such deals would be signed and how the decision to merge with or acquire another firm would be based on how beneficial the transaction could be in leveraging tax advantages.

In Table 4, correlation analysis reveals that Market Capitalisation and Number of Deals is positively and significantly correlated (p-value of 0.000). This further indicated that as the firm's size increased, the Number of Deals signed, during the period of the study, also increased. Therefore, the results show a higher frequency of merger and acquisition decisions made by the management of the higher Market Capitalisation firms who are more frequently involved in signing merger and acquisition deals. Therefore, it is possible that the prospect of gaining tax advantages may influence merger and acquisition deals. The association between Market Capitalisation and Tax Shields indicated above further supports the hypothesis.

Further, Table 4 reveals that Market Capitalisation and Deal Value are also positively and significantly correlated. The strength of the relationship is calculated at 0.435, with a (p-value of 0.000). The strong association between these two variables is an indicator that the bigger the firm size, the higher the value of the deals. This further illustrates that the management of high Market Capitalisation firms may well be interested in investing even in the most expensive deals. Whether this is a result of management's self-interest, as indicated through agency theory, is arguable. If there is an incentive to increase shareholder value, profits and other financial incentives, the investment in such deals which promise high returns, as a result, illustrate that high Market Capitalisation firms may crystallise this tax advantage.

Another significant association was discovered between Market Capitalisation and Dividends (p-value at 0.032). Consequently, as Market Capitalisation increases, the dividends will also increase. A further significant association was found between Dividends and the Number of Deals, with a (p =t 0.039). Firms with higher Market Capitalisation are more frequently involved in mergers and acquisitions and are investing more funds into such deals. They are yielding greater dividends, providing evidence that these firms are gaining tax advantages. Similar results were found by Kaplan and Strömberg,[129] who concluded that for most firms involved in merger and acquisition deals, the level of dividend payments (a form of tax advantage) increased considerably following the completion of such deals. This result has also been supported by past studies that explain the growth in merger and acquisition deals

[128] Brailsford and Knights, (n 53).

[129] Steven N Kaplan and Per Strömberg, 'Financial Contracting Theory Meets the Real World: An Empirical Analysis of Venture Capital Contracts' (2003) 70(2) *Review of Economic Studies* 281.

via a significant relationship detected between high market capitalisation firms and an increase in dividends.[130]

Number of Deals and Deal Value resulted in a positive significant relationship (p-value of 0.000). This result shows that the higher the number of deals, the higher the value of the deal being studied in the sample for each company. Arguably, higher Market Capitalisation firms are more actively involved in signing merger and acquisition deals even if the deals require high investment. Management makes decisions in favour of such deals in anticipation of tax advantages. The result is similar to other studies that found that higher market capitalisation firms are more readily open to merger and acquisition opportunities as they have the funds to invest and view this as a way to further maximise their profits.[131] A positive and significant correlation was also found between Tax Shields and Book Effective Tax Rate (p = 0.040). This signifies that although the Tax Shields used by firms (high, medium and low Market Capitalisation) increase, at the same time, the Book Effective Tax Rate also increases.

However, the remaining associations were not found to be significant. This includes the relationship between Dividends and Book Effective Tax Rate. Consequently, merger and acquisition firms that pay higher dividends may also pay Book Effective Tax Rates but not as high as the Dividends, indicating some desire to obtain tax advantages within such firms. Likewise, the relationship between Dividends and Cash Effective Tax Rate was not significant, and further, the association between Dividends and Deal Value was not significant. This indicates that whether the Dividend payments increase or decrease, there is no relationship with the increase and decrease in the value of the deals. In other words, it means that firms with an increase in Dividends after the merger and acquisition deals may not have necessarily invested in high-value deals. This, perhaps, may also indicate that the increase in Dividends after merger and acquisition deals is also common in companies with medium or low Market Capitalisation. As opposed to larger firms, small and medium-sized firms do not acquire high-valued deals; however, they do experience an increase in dividends following merger and acquisition deals.

Further, the relationship between Dividends and the Global Financial Crisis was not significant, as was the case between Market Capitalisation and the Global Financial Crisis. The negative association indicates that the deals signed by higher Market Capitalisation firms increased in the years after the Global Financial Crisis. Consequently, potential tax advantages may be gained after a financial crisis to sustain profit/earnings after economic setbacks.[132] Arguably, it could just be that firms are keen to retain earnings and look to business reinvestment during a period of uncertainty. This outcome accords with findings of previous research that show that during a financial crisis, investments that ensure survival are prevalent.[133] The result may also have implications in the current Covid -19 environment post-2020.

[130] For example see Sydney Finkelstein and Cary L Cooper (eds), *Advances in Mergers and Acquisitions: Volume 17* (Emerald Publishing Limited, 2018).
[131] Lim (n 74) 142.
[132] Andrew Hood, Robert Joyce and Jonathan Cribb, *Recessions, Income Inequality and the Role of the Tax and Benefit System* (The IFS, 8 November 2017) <https://www.ifs.org.uk/uploads/publications/comms/R137.pdf>.
[133] Brodonlo (n 96).

Finally, no significant relationship was observed between Deal Value and Cash Effective Tax Rate and Book Effective Tax Rate and Cash Effective Tax Rate. Consequently, the cash payments of taxes are lower than book payments, which arguably could be facilitated through tax shields and other tax advantages gained as a result of merger and acquisition deals. This is contrary to the findings of other studies that have found a close association between tax benefits and merger and acquisition deals.[134] The lack of association between the Effective Tax Rates and Market Capitalisation may be further explained with reference to the weak positive correlation between BETR and CETR. This association indicates that while merger and acquisition firms experience an increase in their BETR, they also may subsequently see some increase in their CETR. The difference between cash tax payments and book tax payments, could also be due to the presence of tax shields and other tax benefits obtained through merger and acquisition transactions.

Overall, the results of the correlations support hypothesis H1 in part. The significant relationships discovered between Market Capitalisation and Tax Shields, along with the payment of dividends and the number of deals done, suggest that tax advantages were present to some degree. The results support the findings of Raymond and Terry,[135] who also found a significant relationship between merger and acquisition deals, profits and tax benefits.

V CONCLUSION

A *Summary and Findings*

This study examined the potential tax advantages obtained by Australian-based acquiring firms with higher Market Capitalisation as a result of a merger and acquisition deal. To understand the tax advantages that firms with higher Market Capitalisation can gain following merger and acquisition deals, the study analysed the pattern and change in various tax characteristics, with a focus on effective tax rates, dividends, tax shields, the number of deals and the value of those deals.

The correlation results show a strong association between firms with higher market capitalisation and certain tax advantages through merger and acquisition deals. In particular, it was found that most high market capital firms were frequently involved in merger and acquisition transactions and continued to invest funds into such deals. Specifically, it was found that there was a strong association between higher market capitalisation firms and the increase in the payment of dividends following the signing of merger and acquisition deals and the frequency in the number of deals done. There was also a strong association between high market capital firms and the utilisation of tax shields. Consequently, the results partly support, H1 that Australian acquirer firms with higher market capitalisation gain significant tax advantages through merger and acquisition deals. The qualification is largely based on

[134] Ciobanu and Dobre, (n 29) 57.
[135] De Silva Rosa and Walter, (n 62).

the lack of association found between high market capitalisation firms and effective tax rates post-merger and acquisition deals.

B *Tax Policy Implications*

This study has potential tax policy implications with regard to merger and acquisition deals in Australia. In particular, policymakers need to be aware that companies may enter merger and acquisition deals for reasons that are not just purely commercial. This research has shown potentially significant tax advantages from such transactions can transpire, which may represent a risk to the revenue. However, further research needs to be undertaken to determine whether the extent of merger and acquisition deals necessarily constitutes tax avoidance/evasion, which is beyond the scope of this study.

As the study suggests that high market capitalisation firms in Australia actively participate in merger and acquisition deals, it may be necessary to monitor those deals more closely through moderate audit activity. For instance, those firms that frequently sign merger and acquisition deals may need to be audited on a regular basis to determine the presence, if any, of tax advantages gained. In addition, those firms that experience a significant increase in the distribution of dividends after merger and acquisition deals may also require closer scrutiny by the tax authorities, particularly in a post-COVID-19 environment.

VI STUDY LIMITATIONS AND SUGGESTIONS FOR FURTHER RESEARCH

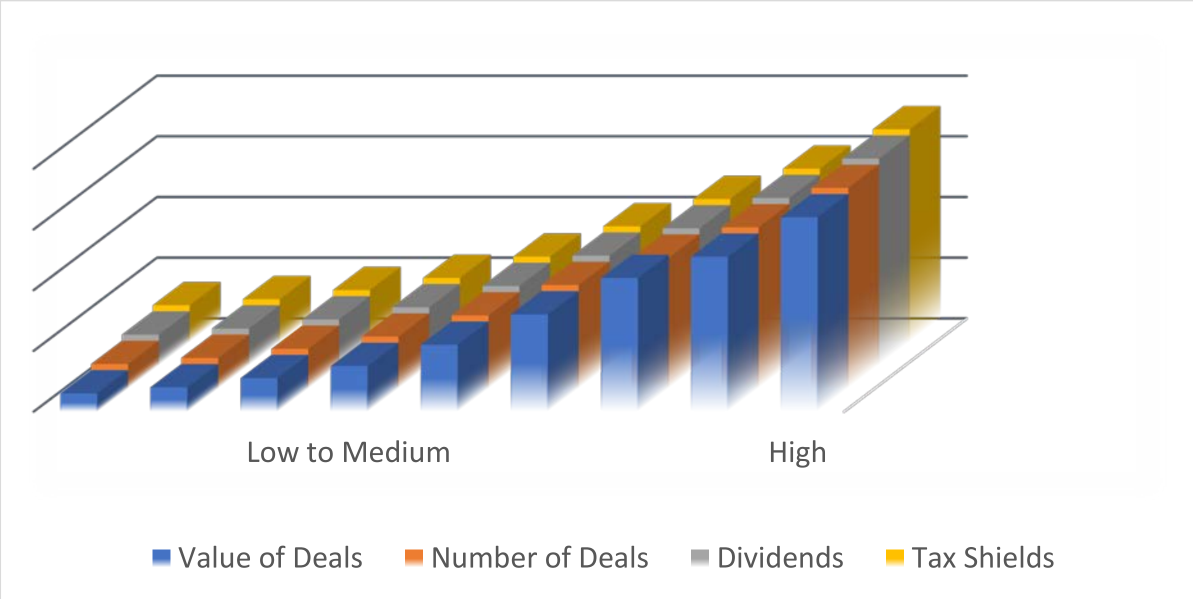
A limitation of this study is that its scope is confined to Australian-based merger and acquisition deals. It does not include deals that involve both Australian and international parties. Those deals could provide further insights and may be an area of interest for future research. Another limitation is that since it is based on a comparison of pre- and post-merger and acquisition periods, more recent examples could not be included in the analysis. Therefore, there are no observations from the year 2015 onwards. More recent data could provide more clarity into the present state of affairs. Instead of comparing periods further research could also draw a comparison between similar industry merger and acquisition firms or do a sector-wise comparison between merger and acquisition firms.

In addition, the scope of the study did not allow the research to take into account the behavioural aspect of the managerial role in merger and acquisition deals. Therefore, future studies could examine how management's mindset and personal beliefs may influence a firm's decision. Likewise, a legal analysis of the general anti-avoidance rules was also beyond the scope of this paper and may have an important place in any future research.

Nevertheless, this paper makes a valuable contribution to the existing literature by providing original empirical evidence which highlights that some merger and acquisition deals, in the Australian context, have led high market capitalisation firms to gain significant tax advantages, which pose a risk to the revenue and should not go unnoticed.

APPENDIX

Figure.1. Tax advantages of Australian acquirer firms with higher market capitalisation show an increase following merger and acquisition deals.



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