

OFF-BALANCE-SHEET FINANCING, BOOK-TAX  
DIFFERENCES AND FIRM ATTRIBUTES

By

TONG (ROBERT) YU

Bachelor of Economics in Tourism Management  
Hangzhou University of Commerce  
Hangzhou, Zhejiang  
1998

Master of Science in Hospitality Administration  
Oklahoma State University  
Stillwater, Oklahoma  
2005

Master of Science in Accounting  
Oklahoma State University  
Stillwater, Oklahoma  
2006

Submitted to the Faculty of the  
Graduate College of the  
Oklahoma State University  
in partial fulfillment of  
the requirements for  
the Degree of  
DOCTOR OF PHILOSOPHY  
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DIFFERENCES AND FIRM ATTRIBUTES

Dissertation Approved:

Sandeep Nabar

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Dissertation Adviser

Bradley Blaylock

---

Angela Spencer

---

Ramesh Rao

---

Outside Committee Member

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Abstract: Prior research has reported a growing gap between book income and taxable income in the 1990s but the causes for this gap are not fully understood. A relatively unexplored potential cause of the increasing book-tax gap is the growth in off-balance financing over the same period. In this study, I first investigate whether off-balance-sheet financing arising from synthetic leases and securitization explains variation in book-tax differences. I find a positive and significant relation between off-balance-sheet financing and book-tax differences. The approximate magnitude of the effect of off-balance-sheet financing on book-tax differences is between 1-2 percent for the securitizations and 40 percent for synthetic leases. I next examine whether off-balance-sheet financing affects the relation between book-tax differences and various firm attributes documented in prior literature, such as earnings persistence, analyst forecast errors, and audit fees. I find some evidence that lower earnings persistence is associated with positive temporary book-tax differences arising from off-balance-sheet financing. I do not find a significant association between forecast errors and book-tax differences arising from off-balance-sheet financing. I find that there is a positive relation between audit fees and off-balance-sheet financing. However, I find no evidence that off-balance-sheet financing drives the positive association between audit fees and book-tax differences.

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## CHAPTER I

### INTRODUCTION

Book-tax differences are the gap between the book income reported on a company's income statement and the taxable income on its tax return. Prior research has documented an increasing gap between book income and taxable income in the 1990s (e.g., Mills et al. 2002; Plesko 2002 and 2004). Although the causes for the gap are not fully known, tax shelters and upwards earnings management are often assumed to be the major causes (e.g., Desai 2003; Seidman 2010). Some research suggests that off-balance-sheet financing could also contribute to the growing gap (Mills et al. 2002; Mills and Newberry 2005).<sup>1</sup> However, there is a paucity of empirical evidence on the relation between off-balance-sheet financing and book-tax differences. This study first examines whether off-balance-sheet financing explains variation in book-tax differences. Following prior research (e.g., Mills and Newberry 2005), I focus on two types of off-balance-sheet

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<sup>1</sup> Mills and Newberry (2005) find that credit-constrained firms use off-balance-sheet financing to lower borrowing costs and to enhance balance sheet presentation. They use the difference in interest expense per financial statements and corporate tax returns to proxy for a firm's off-balance-sheet and hybrid financing. Thus, their study does not directly test the effect of off-balance-sheet financing on book-tax income differences.

financing that can generate book-tax differences, synthetic leases and securitizations, and refer to them collectively as off-balance-sheet financing.

After establishing the relation between off-balance-sheet financing and book-tax differences, I further examine whether the association between book-tax differences and firm attributes documented in prior literature varies with off-balance-sheet financing.

Understanding the source of book-tax differences is important because recent inquiries suggest the effect of book-tax differences on future firm performance and on financial statement users depends on the source of such differences (e.g., Ayers et al. 2010; Blaylock et al. 2012; Hanlon et al. 2012).

Prior research has studied the implications of book-tax differences for earnings persistence (Hanlon 2005; Blaylock et al. 2012), analyst forecast errors (Weber 2009), and audit risk (Hanlon et al. 2012). These studies suggest that the association between book-tax differences and these attributes is driven primarily by accrual quality (e.g., Blaylock et al. 2012; Hanlon et al. 2012). I argue that off-balance-sheet financing such as synthetic leases and securitizations may also be an important contributing factor in driving these relations for firms with such financing structures for the following reasons.<sup>2</sup> First, prior research finds that the use of off-balance-sheet financing is associated with future financial, operating, and credit risks (Barth et al. 2011; Dhaliwal et al. 2011). Consequently, the related book-tax differences can reflect these risks and thus have implications for future firm performance. For example, the lessee firm in a synthetic lease bears the risk of loss when the value of leased

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<sup>2</sup> Examining off-balance-sheet financing that creates book-tax differences may raise the question of why I do not directly investigate the underlying financing transactions. My analysis is in the spirit of Blaylock et al. (2012) who argue that book-tax differences offer “a useful aggregate or summary measure of firms’ accounting choices” (101). Instead of analyzing voluminous synthetic leases and securitizations, financial statement users could gather information and formulate judgments about firm risk and future performance using this easy and less time-consuming method. In addition, the effect of off-balance-sheet financing on firm future performance may not be easily discernible from the disclosures in financial statements. For example, Raedy et al. (2011) show that investors ignore the detailed disclosures in the tax footnotes due to complexity.

property drops below the guaranteed residual value at the end of lease term. Second, off-balance-sheet synthetic leases and securitizations introduce operating and information complexity, which may impact analyst forecasts and audit risk. For example, analysts may not fully appreciate the implications of off-balance-sheet financing for future firm performance due to increased firm complexity, and auditors may view clients with these structures as risky. Finally, book-tax differences arising from off-balance-sheet financing may reflect balance sheet and real earnings management, which is possibly more detrimental to a firm's future performance than accrual management. The negative effect of real-transaction based management may result from its adverse impact on optimal business operations. Thus, my second research question examines how these off-balance-sheet structures affect the relation among book-tax differences and earnings persistence, forecast errors, and audit fees.

To address the first research question, I use a cross-sectional Ordinary Least Squares (OLS) model to test the relation between book-tax differences and off-balance-sheet financing. The model controls for other sources of book-tax differences including accrual earnings management and tax avoidance. It also includes other potential confounding factors used in prior research such as in studies by Manzon and Plesko (2002) and Frank et al. (2009). I use four samples including three securitization samples and one synthetic lease sample and test the relation between off-balance-sheet financing and three types of book-tax differences (total, temporary, or permanent). I find a significant and positive relation between off-balance-sheet financing and total book-tax differences for all samples. The size of the effect is greater for synthetic leases than for securitizations. For temporary book-tax differences, I find the coefficient on off-balance-sheet financing is significantly positive only

for the synthetic lease sample. For permanent book-tax differences, I also find the coefficient on off-balance-sheet financing is significant for two of the four samples.

To examine the second question, I develop three hypotheses. For each hypothesis, I construct two samples. One sample, “*Matched*”, is based on a one-for-one match for all firm-years with off-balance-sheet financing. The matching is implemented based on two-digit SIC industry, year, and firm size. The second sample, “*S&P*”, is based on S&P 500 firms. For this sample, I compare firms in the S&P 500 with off-balance-sheet financing for a particular year with S&P 500 firms that do not have such financing over the sample period. Following prior research, I employ three OLS regression models to test whether off-balance-sheet financing affects the relation between book-tax differences and three firm attributes. First, I test whether earnings persistence is lower for firm-years with positive book-tax differences arising from off-balance-sheet financing. I find that for firm-years with positive temporary book-tax differences, book-tax differences arising from synthetic leases are associated with lower earnings persistence. I also find a negative association between earning persistence and book-tax differences arising from off-balance-sheet financing based on a securitization and lease combined sample for firm-years with positive temporary book-tax differences. This evidence provides some support for my first hypothesis. Additionally, I find a negative relation between earnings persistence and book-tax differences arising from synthetic leases for firm-years with positive permanent book-tax differences. However, I do not find a significant relation between earnings persistence and book-tax differences arising from securitizations.

Second, I examine whether analyst forecast errors are greater for firm-years with book-tax differences arising from off-balance-sheet financing. I construct my model

following Weber (2009), who finds a positive relation between forecast and book-tax differences. For all samples, I find that the relation between forecast errors and book-tax differences is not significantly more pronounced for firms with off-balance-sheet financing than for firms without such structures. Further, the findings show an insignificant association between forecast errors and book-tax differences arising from likely accrual management or tax avoidance. This result suggests that the positive relation between book-tax differences and forecast errors is not driven by any particular source of book-tax differences.

Finally, I examine the effect of off-balance-sheet financing on the relation between audit fees and book-tax differences. Consistent with Hanlon et al. (2012), I find a positive association between audit fees and book-tax differences. In addition, the findings show that audit fees on average increase for firms with off-balance-sheet financing, suggesting auditors incorporate the complexity and risks associated with off-balance-sheet financing in their pricing decisions. However, I do not find that audit fees increase with book-tax differences arising from off-balance-sheet financing. These findings suggest that the positive association between audit fees and book-tax differences is not driven by off-balance-sheet financing.

This study is important in several ways. First, it contributes to the book-tax differences literature by directly examining the effects of off-balance-sheet financing on book-tax differences. While prior research investigates various sources of book-tax differences and uses book-tax differences to proxy for accrual management or tax avoidance, only one study suggests that the difference in interest expenses between financial accounting and tax reporting may be associated with off-balance-sheet financing (Mills and Newberry 2005). My study extends prior literature by including off-balance-sheet financing as a potential source of book-tax differences. I find evidence that book-tax differences increase

with off-balance-sheet securitization and synthetic leases. Additionally, I add to prior research by separately examining the effects of synthetic leases and securitization on book-tax differences using publicly available data. Findings from this study can help researchers quantify the effect of these specific types of off-balance-sheet financing on book-tax differences.

Second, I extend prior research on the relation between book-tax differences and firm attributes by investigating whether book-tax differences arising from off-balance-sheet financing affect this relationship. Specifically, this study adds to our understanding of the economic implications of book-tax differences. For example, Hanlon (2005) finds a negative association between book-tax differences and earnings persistence. Blaylock et al. (2012) attribute Hanlon's findings to possible accrual earnings management. I offer evidence to show that book-tax differences arising from off-balance-sheet financing may also lead to lower earnings persistence. Further, my study contributes to the auditing literature. In particular, I offer evidence suggesting that off-balance-sheet financing is incorporated into audit fee pricing.

The final contribution of this study is to add to the emerging stream of literature on accounting issues related to off-balance-sheet financing. It directly answers the call by Hanlon and Heitzman (2010) for more evidence on the taxation of financial securities including tax implications of leases and securitizations. Prior research examines the determinants of synthetic leasing, their impact on the future cost of debt, and how synthetic leases affect firm voluntary disclosure (Altamuro 2006; Zechman 2010). I add to this literature by offering evidence on the economic consequences of off-balance-sheet financing on earnings persistence, through its effect on book-tax differences.

The paper proceeds as follows. Chapter II describes the background of synthetic leases and securitization. Chapter III reviews relevant literature. Chapter IV develops the research question and testable hypotheses. Chapter V discusses sample selection and research design. Chapter VI reports empirical findings and Chapter VII concludes.

## CHAPTER II

### BACKGROUND ON OFF-BALANCE-SHEET FINANCING

#### 2.1. Synthetic lease

There are a number of forms of off-balance-sheet financing, such as R&D limited partnerships, operating leases, asset securitizations, and synthetic leases. But only a few of these types may contribute to book-tax differences. Following prior research (Mills and Newberry 2005), I examine two types of off-balance-sheet financing that can generate book-tax differences, synthetic leases and securitizations, and refer to them as off-balance-sheet financing.

Synthetic leases were a popular form of off-balance-sheet financing in the 1990s and early 2000s.<sup>3</sup> It is estimated that the total amount of synthetic lease financing was well over 100 billion in the mid-1990s (Pollert and Glickman 2002). In a typical synthetic lease, a bankruptcy-remote special purpose vehicle (SPV) is set up to acquire or construct

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<sup>3</sup> Firms that employed synthetic leases include Cisco, 3Com, U.S. Airways, and Health South (MacDonald 2002).



a property (e.g., office building) and lease it to a firm (lessee) as an operating lease.<sup>4</sup> The lessee finances through 97% debt from a lender or group of lenders (typically financial institutions) and 3% equity from outside investors (Little 2002).<sup>5</sup> The lessee makes periodic rent payments consisting of interest and a minimal return to equity holders. The interest-only feature of the debt payment makes synthetic leases attractive to credit-constrained firms because they can defer cash outlay. The borrowing rate is normally charged at a small margin over the London InterBank Offered Rate (LIBOR), and thus the borrowing costs are generally lower than conventional mortgage financing, because the SPV is isolated from bankruptcy of the lessee (Altamuro 2006).<sup>6</sup> The lease term also includes a residual value guarantee of the asset provided by the lessee that typically equals 85% of the original property value (Graff 2001). In addition, some covenants of the synthetic lease loans contain a cross-default provision, which means a default on any of the lessee's debt would trigger a default on other obligations. A synthetic lease is usually short-term with an initial term no more than seven years. At the end of the lease term, the lessee has three options: refinance and renew the lease, purchase the asset at a predetermined price, or sell the asset and pay off the debt (Brown 2002). Consequently, the lessee receives the benefits of potential asset appreciation but also bears the downside risk if the value of the asset declines below the residual value guarantee.

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<sup>4</sup> The SPV is a legal entity such as a trust or limited liability corporation with limited activities, so that it is isolated from the lessee's potential bankruptcy and the probability of entering bankruptcy itself is extremely low.

<sup>5</sup> Under EITF 90-15, if the owner of the SPV has made a residual equity investment (a minimum of 3%) in the SPV, the lessee can avoid consolidation of the SPV on its financial statements. To avoid consolidation of the SPV, the lessee typically structures the synthetic lease to have a 3% outside equity investment at risk throughout the lease term (Phillips and Little 2002).

<sup>6</sup> Because LIBOR is a variable rate, firms often engage in hedging transactions such as interest rate swaps to offset the interest rate risk associated with synthetic leases.

Prior to 2003, the lessee typically recorded the lease as an operating lease for financial reporting and kept the leased asset and related debt off the balance sheet. For tax purposes, the tax rules allow the lessee to report the lease as a capital lease. This is because the lessee usually assumes the majority of the risks and rewards of the leased property by guaranteeing most of the SPV debt at the termination of the lease. Thus, the lessee was able to report the arrangement as a capital lease and deduct depreciation on its tax returns because of the perceived ownership of the leased property (Brown 2002). Due to the different treatment of synthetic leases between financial reporting and tax rules, the lessee benefited from keeping related debt off the balance sheet and reporting lower depreciation expense and higher earnings on its financial reports compared to its tax returns (Ratner 1996). Besides the tax depreciation deductions, the lessee also benefited from an improvement in financial ratios, such as return on assets and leverage. The different treatments of synthetic leases between accounting and tax purposes generated a temporary book-tax difference.<sup>7</sup> Appendix A illustrates how a typical synthetic lease is structured, and Appendix B shows some examples of footnote disclosures on synthetic leases.

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<sup>7</sup> A temporary difference is created because the differences in recognition and measurement requirements between the financial accounting and the tax law. Even if the lessee has not recorded an asset and liability for financial reporting purposes, it shall record a deferred tax asset (DTA) and deferred tax liability (DTL) for the future tax consequences related to the depreciation of the property and the amortization of the debt, respectively. A net DTA or DTL generally will arise because the methods of depreciating the property are different from those for amortizing the debt. The DTA and DTL will reverse eventually if the property is held for the full term of the lease (Deloitte 2011).

## 2.2. Securitization

Securitization is a form of financing in which a firm (the originator) sells a pool of financial assets (e.g., loans, leases, and receivables) to a bankruptcy-remote SPV that receives cash from outside investors by issuing debt securities backed by the transferred assets. The debt securities such as commercial paper and notes, are typically known as asset-backed securities (ABS). The cash flow from the transferred assets is used to pay the investors. Financial institutions are often involved as intermediaries to coordinate the securitization process. In a typical securitization, the originator usually retains some interest in the securitized assets. This interest is often referred to as retained interest. Because retained interest is typically the most subordinate tranche of the ABS, the originator retains most of the economic risk (Moody's 2003).<sup>8</sup> Additionally, the upside gain is limited because the originator can only profit from excess cash flow from the securitized assets after other claims are satisfied (Moody's 2003).

Securitization has become an important form of financing for U.S. corporations, and its usage has increased substantially since the 1990s. For example, the outstanding principal amount of ABS in the U.S was \$154 billion in 1993 (Bond Market Association 2011), but this amount surged to \$1.2 trillion in 2001, and continued to grow to nearly \$3 trillion in 2007 (Bond Market Association 2011). Although the financial industry is a major player in the securitization market, some nonfinancial industries such as manufacturing, retail, and real estate also use securitizations. Moreover, there are legitimate reasons for firms to use securitizations, including expanding funding sources,

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<sup>8</sup> Tranche is the portion or slice of asset-backed securities. Each tranche has a different level of credit protection and different investment return based on its seniority. The most senior tranche has priority on the cash flow generated by the securitized assets (Kothari 2006).

lowering borrowing costs, improving capital structure, managing the balance sheet, and enhancing credit ratings (Kothari 2006).

Book-tax differences can arise from securitizations due to the different treatment between financial accounting and tax rules. Under *Statement of Financial Accounting Standards (SFAS) No. 125 and 140*, securitizations can be treated as either a sale or secured borrowing, depending on how much control the originator retains over the transferred assets. However, some firms structure securitization transactions to meet the sales accounting requirements even though they retain considerable risk (Dechow et al. 2010). By recording a securitization as a sale for financial accounting purposes, a firm can not only recognize an up-front gain from the sale but can also avoid reporting the interest expense associated with the SPV, leading to higher earnings and improved financial ratios. On the other hand, the firm may structure securitizations as debt financing for tax purposes (Mangefrida and Beeman 1998; Roever and Fabozzi 2003). As a result, the originator can deduct the interest expense on its tax return and defer the up-front tax on the gains for income taxes purposes (Rosenblatt et al. 2005). Consequently, temporary book-tax differences can arise from securitizations as the gains are recorded upfront for financial reporting purposes, and are recorded as realized over the life of the securitizations for tax reporting purposes. Appendix C shows some examples of footnote disclosures on asset securitizations.

## CHAPTER III

### LITERATURE REVIEW

#### 3.1. Sources of book-tax differences

Book-tax differences arise for various reasons including tax avoidance, earnings management, and mechanical differences between financial accounting and tax rules. Prior research suggests that book-tax differences increase with tax-avoiding activities, resulting in higher book income compared to taxable income. For example, Mills (1998) finds that book-tax differences are positively related to IRS audit adjustments. Desai (2003) argues that the widening book-tax income gap in the 1990s was largely due to increased tax-sheltering activities of U.S. firms. Wilson (2009) documents that tax-shelter firms exhibit large positive book-tax differences which would decrease by an average of 102% if the effect of the shelter were removed. Similarly, Lisowsky (2010) shows that total book-tax differences are significantly and positively associated with his sample of tax shelters.

In addition, prior research shows that book-tax differences could arise from earnings management. For example, Badertscher et al. (2009) find that firms that restated earnings typically employ book-tax non-conforming earnings management, suggesting that positive book-tax differences are created when only book income is managed upward.

Moreover, as the underlying objectives of U.S. GAAP and tax law differ, mechanical applications of the financial accounting and tax rules can generate differences between book and tax income. For instance, income from municipal bond investments, dividends received deductions, and depreciation are treated differently between financial accounting and tax rules. A recent study by Seidman (2010) suggests that changes in accounting principles such as goodwill impairment also contribute to book-tax differences. However, even the application of accounting rules involves managerial discretion and firms may choose to exploit the differences between the two systems. One example is off-balance-sheet financing using synthetic leases and securitization. Mills et al. (2002) show that the book-tax income gap increased steadily in the 1990s while firms reported more assets and liabilities in aggregate on their tax returns than on their financial statements. They suggest that off-balance-sheet financing is a major cause for the increase in book-tax differences. Mills and Newberry (2005) find that credit-constrained firms are more likely to use off-balance-sheet financing such as synthetic leases and securitization. They measure off-balance-sheet financing using the differences in interest expense between financial reporting and tax reporting based on confidential tax returns. However, they do not directly examine the relation between off-balance-sheet financing

and book-tax income differences. One objective of this study is to quantify the effects of off-balance-sheet financing on book-tax-differences.

### 3.2. Book-tax differences and firm attributes

Prior studies have examined the implications of book-tax differences for a number of firm characteristics. One strand of the literature investigates the relation between book-tax differences and earnings attributes and demonstrates that book-tax differences provide useful information for estimating future firm performance. First, book-tax differences are associated with earnings growth and persistence. For example, Lev and Nissim (2004) report that total book-tax differences can predict subsequent five-year earnings growth. In particular, they show that firms with a higher ratio of tax income to book income (smaller book-tax differences) exhibit higher earnings growth. Hanlon (2005) finds that firms with large temporary book-tax differences exhibit lower earnings and cash flow persistence than firms with small temporary book-tax differences. Jackson (2011) divides book-tax differences into temporary and permanent components and separately examines their relation with future earnings. Consistent with Hanlon's findings, he shows that temporary book-tax differences predict future changes in pretax earnings and permanent book-tax differences explain future changes in tax expense. Further, Blaylock et al. (2012) attribute the findings in Hanlon (2005) to temporary book-tax differences arising from accrual earnings management which are associated with lower earnings and accrual persistence as compared to those arising from tax avoidance.

Another stream of studies has examined the capital market implications of book-tax differences. For the equity market, prior research investigates the relation between

book-tax differences and analyst forecasts. Weber (2009) extends the work by Lev and Nissim (2004) and studies the effect of book-tax differences on analysts' earnings forecasts. He finds that forecast errors increase with total book-tax differences, which suggests that analysts fail to incorporate the information contained in book-tax differences into forecasted earnings. He also shows that investors exhibit expectation errors similar to those of analysts. Weber (2009) raises the question of whether the negative implication of book-tax differences for forecast errors depends on the source of such differences.

Hanlon et al. (2012) examine whether auditors incorporate the information risk reflected in book-tax differences in pricing decisions. They show that the absolute value of total book-tax differences is associated with higher audit fees which proxy for audit risk and auditor effort. Specifically, they find that a 10% increase in the absolute value of book-tax differences results in an average increase of \$29,000 in audit fees for firms in the top book-tax differences group. They report that audit fees also increase with both the temporary and non-temporary components of book-tax differences, and the coefficient on non-temporary book-tax differences is greater than that on either total or temporary book-tax differences. They attribute these findings to book-tax differences arising from potential accrual earnings management and from potential issues such as firm complexity and earnings quality concern related to tax accruals. However, their study does not examine whether book-tax differences created by off-balance-sheet financing also affect audit fees.



## CHAPTER IV

### RESEARCH QUESTION AND HYPOTHESIS DEVELOPMENT

#### 4.1. Off-balance-sheet financing and book-tax differences

As discussed in Chapter II, both synthetic leases and securitizations can create book-tax differences. However, no empirical study has directly examined the effect of off-balance-sheet financing on book-tax differences. It is important to include off-balance-sheet financing as a specific source of book-tax differences in empirical research because it often correlates with two other sources of those differences: tax avoidance and earnings management. First, complex tax planning often involves the use of off-balance-sheet structures. For example, Enron used SPVs to inflate the depreciation basis of one of its office buildings and recorded higher depreciation on its tax returns than on its financial statements (Desai 2005). Additionally, firms can manage earnings through off-balance-sheet financing structures. Feng et al. (2009) find that firms create SPVs for financial reporting and tax purposes, and that SPVs created for financial reporting purposes are positively associated with earnings management. Dyreng et al. (2011) find

that both off-balance-sheet structures and operations in tax havens are associated with earnings management. For example, a firm may manage earnings by manipulating fair value estimates in securitizations as documented in Dechow et al. (2010). Managers can also time securitizations at the end of fiscal period to manage earnings as shown in Dechow and Shakespeare (2009). In addition, managers can boost earnings by substituting capital investment with synthetic leases, which may merely delay such expenditure. Note that in these examples, managers choose to engage in real transactions for earnings management purposes.

Although prior research investigates the determinants of book-tax differences, it has not systematically examined the effects of all three sources. Therefore, it is important to examine whether off-balance-sheet financing explains the cross-sectional variation in book-tax differences. The above discussion leads to the following research question:

*RQ: What is the effect of off-balance-sheet synthetic leases and securitizations on book-tax differences?*

#### 4.2. Off-balance-sheet financing, book-tax differences, and earnings persistence

Book-tax differences provide information regarding a firm's future performance. However, the implication of book-tax differences for future earnings depends on the source of the differences. For example, Blaylock et al. (2012) find that the effect of book-tax differences on earnings persistence varies with the source of such differences. Specifically, they show that firms with large positive and temporary book-tax differences arising from accrual earnings management have lower earnings persistence than other firms whose book-tax differences are caused by tax avoidance. They attribute their

findings to the fact that temporary book-tax differences signal future reversal of accrual management in the current period.

In the same spirit, I argue that book-tax differences arising from off-balance-sheet financing may also reflect lower earnings persistence. For example, Ge (2006) finds that off-balance-sheet operating lease financing is associated with lower future operating performance. She suggests that the negative relation may be explained by diminishing marginal returns from capital investments in operating leases. However, one explanation that Ge did not explore is that synthetic leases introduce added uncertainty to a firm's future operation. For example, the lessee firm faces a downside risk from the decline in asset value at the end of the lease. If the asset value drops below the guaranteed residual amount, the firm would bear the loss and record an impairment charge to earnings. Furthermore, for firms that do not use derivatives to hedge the interest rate risk associated with synthetic leases, the variable interest introduces potential volatility to future earnings. Thus, I expect that the book-tax differences arising from synthetic leases signals lower persistence in earnings.

Similarly, book-tax differences arising from securitizations may reflect lower earnings persistence for the following reasons. First, sales accounting allows a firm to accelerate income from securitizations as compared to secured borrowing accounting. If firm growth slows, future earnings from securitizations will decrease (Ryan 2002). Second, substantial subjective judgments are used in securitization, which could result in volatility in earnings due to unexpected prepayments, credit losses, and interest rate movements (Rosenblatt et al. 2005). Moreover, as firms keep a retained interest in the securitized assets which are typically most subordinate, they bear the risk of first loss

from securitization when there are defaults on the payment for the securitized assets (Moody's 2003). Empirical evidence shows that securitization gains are less reliable if firms securitize more assets (Niu and Richardson 2006). Prior research also suggests that managers use securitizations for opportunistic gains (Dechow and Shakespeare 2009; Dechow et al. 2010). For example, Dechow and Shakespeare (2009) document that managers time securitization transactions at quarter-end to manage earnings. Additionally, managers can manipulate earnings from securitizations using discount rates in calculating the fair value of retained interest (Dechow et al. 2010).<sup>9</sup> Because firm growth may eventually decline and managerial opportunistic behavior only works in the short run, real economic performance surfaces in future years, and earnings from these transactions exhibit lower persistence.

Phillips et al. (2003) predict that large positive book-tax differences provide information about earnings management because managers have more discretion under GAAP than under tax law. Consistent with their conjecture, they show that deferred tax expense helps detect earnings management after controlling for discretionary accruals. Consequently, I focus my investigation on firms with positive book-tax differences. As prior research finds positive book-tax differences reflect lower earnings persistence (Hanlon 2005; Blaylock et al. 2012), I state my first hypothesis as follows (in alternative form):

*H1: For firm-years with positive book-tax differences, earnings persistence is negatively associated with the use of synthetic leases and securitizations.*

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<sup>9</sup> Although some firms may structure off-balance-sheet financing for the “benefits” of managing earnings and avoiding tax, there are also other incentives to engage in these transactions including lowering borrowing costs, managing the balance sheet, and enhancing credit ratings.

#### 4.3. Off-balance-sheet financing, book-tax differences, and analyst forecast errors

Synthetic leases and securitizations can create information asymmetry between a firm and the users of its financial statements because of inherent complexity, uncertainty, and inadequate disclosure. If the users are uncertain about the true value of the off-balance-sheet assets and liabilities, it would be challenging for them to gauge their effect on future earnings. For example, Comprix et al. (2011) study the effect of book-tax differences on divergence of opinion among equity investors. They report that firms with higher total book-tax differences exhibit higher information uncertainty, and that the permanent component of book-tax income differences is more positively associated with their measures of uncertainty than the temporary component.

Although financial analysts are considered sophisticated users of financial statements, empirical evidence suggests that they may not see through the implications of obscure off-balance-sheet obligations for future earnings. Prior research finds that analysts fail to incorporate changes in off-balance-sheet pension information into their forecasted earnings (Picconi 2006), and that forecast dispersion is higher for banks with asset securitizations than non-securitizing banks (Cheng et al. 2011). A recent study finds that forecast errors increase with the magnitude of book-tax differences, suggesting that analyst forecasts fail to fully reflect information contained in book-tax differences (Weber 2009). As Weber (2009) does not examine which source of book-tax differences results in forecast errors, the next natural step is to investigate whether analysts fully appreciate the implication of book-tax differences arising from off-balance-sheet financing for future earnings.

My next hypothesis is stated as follows (in alternative form):

*H2: The positive association between forecast errors and book-tax differences is stronger for firms with the use of synthetic leases and securitizations.*

#### 4.4. Off-balance-sheet financing, book-tax differences, and audit fees

A recent survey by Heltzer and Shelton (2011) finds that auditors generally link large book-tax differences to higher audit risk. The survey shows that auditors claim to use book-tax differences to evaluate audit risk. Consistent with this field evidence, Hanlon et al. (2012) find that firms with larger book-tax differences incur higher audit fees, a measure of audit risk and auditor effort. They report that the positive relation between audit fees and book-tax differences is mainly due to book-tax differences associated with accrual earnings management, suggesting that the source of book-tax differences matters to auditors in assessing audit risk. They suggest that other factors such as firm complexity could also help explain the results.

To the extent that auditors are able to discern the source of book-tax differences, I expect higher audit fees for firms with book-tax differences arising from off-balance-sheet financing. This is because book-tax differences arising from synthetic leases and securitization may signal increased operating uncertainty and firm risk. First, the structure of these transactions is typically complex and involves multiple parties including SPVs, financial institutions, and outside investors (Little 2002; Ryan 2002). The use of derivatives by some firms to hedge interest risk associated with synthetic leases and securitizations further increases firm complexity. Additionally, management can use securitizations and synthetic leases for opportunistic incentives. For synthetic leases, because the risk of a lessee firm default is not insignificant (Graff 2001), managers have incentives to manage earnings to avoid covenant violation due to the

cross-default provision under synthetic leases. For example, Dechow et al. (2011) show that off-balance-sheet operating leases are positively associated with the likelihood of earnings misstatement. Specifically, they find high usage of operating leases during misstatement periods. For securitizations, audit risk or auditor effort is expected to be higher than for other routine transactions in non-financial firms, because securitization requires considerable management judgment and estimation. Recent empirical evidence suggests that firms manage earnings from securitizations by manipulating fair value estimations (Dechow et al. 2010). Thus, I expect that auditors are cautious about the assumptions made by management in determining gains from securitizations and price the associated risk accordingly.

Moreover, off-balance-sheet transactions can create uncertainty about a firm's underlying economic performance and opacity in its financial reporting, both of which can result in information asymmetry between the firm and its auditor. Prior literature suggests that the disclosure of off-balance-sheet transactions is often viewed as insufficient, low quality, or absent (CFA Institute 2008; Chandra et al. 2006; Ernst & Young 2008; FASB 2008). The paucity of information about off-balance-sheet financing may be due to a desire for opaque reporting (e.g., Zechman 2010), but it may also be due to lack of available information.<sup>10</sup> Accordingly, audit risk or auditor effort is expected to increase if the auditor cannot fully discern the effects of these transactions on financial statements. In order to control the detection risks associated with auditing the off-balance-sheet financing transactions, auditors will have to either increase the inherent risk

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<sup>10</sup> In a comment letter on FASB's *Disclosures about Transfers of Financial Assets and Interests in Variable Interest Entities*, Ernst & Young (2008) indicates that firms may not meet some disclosure requirements because information is not centralized or available in the financial reporting system. Moreover, even if a firm has raw information about securitizations to meet the enhanced disclosure requirements, compilation of such data can be difficult.

of the client or audit effort, both leading to higher audit fees. A recent study shows that auditors are wary of off-balance-sheet operating leases and pension obligations, and audit fees increase with the magnitude of these off-balance-sheet obligations (Krishnan and Sengupta 2011). Therefore, book-tax differences arising from off-balance-sheet financing are expected to result in higher audit fees.<sup>11</sup>

The above discussion leads to my final hypothesis (in alternative form):

*H3: The positive association between audit fees and book-tax differences is stronger for firms which use synthetic leases or securitizations.*

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<sup>11</sup> One recent study based on the banking industry suggests that auditors did not appear to price the risk associated with securitization until the recent global financial crisis (Zhang et al. 2011).



## CHAPTER V

### SAMPLE SELECTION AND RESEARCH DESIGN

#### 5.1 Sample selection

To examine my hypotheses, I use two test samples. I construct a matched sample (*Matched*). Each firm-year observation with securitization gains (or synthetic leases) is matched with a control firm-year which does not have securitizations or synthetic leases.<sup>12</sup> I use firm-years with securitization gains as a measure of off-balance-sheet financing for my study because book-tax differences arise from securitizations only when gains are recorded on financial statements but not on tax returns. The matching is implemented based on two-digit SIC, year, and size. Separately, I also construct a test sample based on S&P 500 companies (*S&P*). For this sample, I first identify firm-years in the *Matched* sample with securitization gains (or synthetic leases) which are also in S&P 500. I then match these firm-years with firm-years from other S&P 500 firms which do

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<sup>12</sup> If a firm reports a securitization or synthetic lease in any given year during my sample period, I then exclude it from the control group.

not report any securitization or synthetic lease for the entire sample period. For both the *Matched* and *S&P* samples, I require the entity to be a corporation and exclude financial institutions, utilities, and companies incorporated outside the United States because of their unique regulatory, tax and financial reporting characteristics.

The sample period is 1994-2002 for synthetic leases and 1991-2006 for securitizations. The 10k filings that I use to collect off-balance-sheet information start with 1993 because most of the 10k filings in the Edgar database became available in electronic format after 1993.<sup>13</sup> In January 2003, the FASB issued *Financial Interpretation No. 46 (FIN 46)* which requires most entities to consolidate synthetic lease SPVs and thus considerably restricts a firm's ability to keep synthetic lease debt off its balance sheet. To avoid the effect of *FIN 46*, my synthetic lease sample period ends at 2002. The sample period for securitization samples stops at 2006 to avoid potential confounding factors related to the recent financial crisis.

I obtain the synthetic lease data from the DealScan database and from 10K filings in the directEdgar database. I search the filings with the key words "synthetic leas\*" or "(residual w/10 guarantee) w/30 (operating leas\* or rent\*)." I then read the filings to determine the accounting treatment of the lease. I collect securitization data from 10K filings in the directEdgar database. I search directEdgar with key words "securitiz\*", "sell receivabl\*", or "sale of receivable\*". Then I read each filing to determine whether the firm uses securitization, its accounting treatment, and the size of securitization gains.

For the test of *H2*, I gather analyst forecast data from the I/B/E/S detail file. For the test of *H3*, I collect audit fee data from the AuditAnalytics database. The sample

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<sup>13</sup> The securitization sample starts with 1991 because firms reported their 1991 securitization activities in their 1993 filings.

period for the audit fee tests starts in 2000 because of the availability of audit fee data in AuditAnalytics. I construct other variables in the models using data from Compustat and CRSP and exclude firm-years that do not have sufficient data for my tests. In the empirical analysis, I conduct tests using both the *S&P* sample and the matched sample.

## 5.2 Off-balance-sheet financing and book-tax differences

My research question examines the effect of off-balance-sheet financing on book-tax differences. Following prior literature (e.g., Manzon and Plesko 2002; Frank et al. 2009), I investigate this question by estimating the following pooled cross-sectional OLS regression:

$$\begin{aligned}
 BTD_t = & \beta_0 + \beta_1 OBSF_t + \beta_2 CashETR_t + \beta_3 DISACC_t + \beta_4 Growth_t + \beta_5 \Delta NOL_t + \beta_6 LOSS_t \\
 & + \beta_7 FOREIGN_t + \beta_8 NPPE_t + \beta_9 Intang_t + \beta_{10} Equity_t + \beta_{11} MI_t + \beta_{12} LAGBTD_t \\
 & + \varepsilon
 \end{aligned}
 \tag{1}$$

where *BTD* is measured using total, temporary, or permanent book-tax differences. Total book-tax difference (*BTD*) is book income minus estimated tax income scaled by lagged assets. Book income is pre-tax income. Estimated taxable income equals the sum of the current federal tax expense and the current foreign tax expense divided by the 35% maximum federal statutory rate and less the change in NOL carryforwards. Temporary book-tax difference (*TEMP*) is the sum of U.S and foreign deferred tax divided by the 35% statutory rate and then scaled by lagged assets. Permanent book-tax difference (*PERM*) equals *BTD* less *TEMP*. *OBSF* captures a firm's off-balance-sheet financing. It is measured either as a dummy variable (*OBS*) with a value of one if a firm-year has any securitization gain or synthetic lease, and zero otherwise, or as the amount of securitization gain (*Secu\_Gain*) divided by lagged assets. I expect a positive sign on

*OBSF* as I predict book-tax differences increase with off-balance-sheet financing.

*CashETR* is the long-run cash effective tax rate measured as the sum of cash taxes paid over the previous 5 years divided by the sum of pretax income over the previous 5 years (I use 3 years if 5 years of data are unavailable).<sup>14</sup> Dyreng et al. (2008) argue that tax-avoiding firms are able to maintain a low tax rate over a long period of time. This measure has been used as a broad measure of tax avoidance in prior studies (e.g., Ayers et al. 2010; Kim et al. 2011; Blaylock et al. 2012; Hanlon et al. 2012). As a lower *CashETR* suggests higher tax avoidance, I expect a negative sign on *CashETR*. *DISACC* is discretionary accruals measured as the residual from the modified Jones model, estimated by year and industry (two-digit SIC) with lagged return-on-assets as an additional regressor. To the extent that accrual management generates higher book income than tax income, I expect a positive sign on *DISACC* when *BTD* is measured by total book-tax differences.

Following prior research, I include a set of control variables to account for the mechanical differences between the accounting and tax rules (e.g., Manzon and Plesko 2002; Frank et al. 2009). *Growth* is measured by change in net sales. As growth firms are likely to heavily invest in tax-favored assets, I expect that *Growth* is positively associated with *BTD*. *ANOL* is the change in net operating loss carryforwards. To the extent firms with increased *NOL* are less likely to avoid tax, I expect to find a negative association with *BTD*. *Loss* is an indicator variable which equals one if a firm reports negative pretax

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<sup>14</sup> As off-balance-sheet financing may decrease cash effective tax rates, *CashETR* potentially offsets the effect of off-balance-sheet financing on *BTD* when both cash effective tax rates and off-balance-sheet financing are independent variables. To overcome this potential problem, I also use an alternative measure of *CashETR* by regressing *CashETR* on off-balance-sheet financing and taking the residual as a proxy for tax avoidance. The residual, *CashETR\_Alt*, thus represents *CashETR* not generated by off-balance-sheet financing.

income and zero otherwise. Since loss firms have less incentive to avoid tax than profitable firms, I expect *Loss* to be negatively associated with *BTD*. *NPPE* is the ratio of net property, plant, and equipment to gross property, plant, and equipment. It is included to control for the difference in depreciation rules between financial and tax reporting, and I expect it to be positively associated with *BTD*. *Intang* is goodwill and other intangibles and is included to control for differences in accounting for goodwill and other intangible assets between the financial and tax rules. *Equity* is income or loss attributable to the equity method, and *MI* is income or loss attributable to minority interests. These two variables are included to account for differences between the financial and tax rules on equity interests in less than 100 percent-owned entities. *LAGBTD* is the lagged book-tax differences. I also include *Year* and *Industry* dummies to control for year and industry effect.

### 5.3 Test of H1

I test *H1* using firm-years with positive total (temporary or permanent) book-tax differences. Consistent with prior research (Hanlon 2005; Blaylock et al. 2012), I specify the following OLS regression by adding the off-balance-sheet financing variables to test the effect of off-balance-sheet financing on the relation between book-tax differences and earnings persistence:

$$\begin{aligned} \text{Lead\_PTBI} = & \beta_0 + \beta_1 \text{OBS} + \beta_2 \text{TaxAvoid} + \beta_3 \text{AEM} + \beta_4 \text{PTBI} \\ & + \beta_5 \text{PTBI} * \text{OBS} + \beta_6 \text{PTBI}_t * \text{TaxAvoid} + \beta_7 \text{PTBI} * \text{AEM} + \varepsilon \quad (2) \end{aligned}$$

where *Lead\_PTBI* is next year pre-tax book income deflated by current year assets. *PTBI* is pre-tax book income deflated by lagged assets. *OBS* is an indicator variable which equals one if a firm reports a securitization gain (or synthetic lease) for a year, and zero

otherwise. *TaxAvoid* is an indicator variable which equals one for firm-year observations within the positive book-tax differences group and with *CashETRs* in the lowest quintile of all firm-years in the sample and without synthetic leases or securitizations, and zero otherwise. *AEM* is an indicator variable which equals one for firm-year observations within the positive book-tax differences group, with modified Jones model discretionary accruals in the top quintile of all firm-years, not in the *TaxAvoid* subsample and without synthetic leases or securitizations, and zero otherwise. If off-balance-sheet financing is the likely predominant source of book-tax differences, such book-tax differences group may signal inefficient investment or uncertainty about future earnings, both of which could reduce the persistence of earnings. Therefore, I expect a negative sign on *PTBI\*OBS*. The coefficient on *PTBI* ( $\beta_4$ ) stands for the earnings persistence for firm-years with positive book-tax differences that are not considered as off-balance-sheet financing, earnings management, or tax avoidance firms. Consistent with Blaylock et al. (2012), I expect a negative coefficient on *PTBI\*AEM* as earnings are expected to be less persistent for firm-years with positive book-tax differences resulting from accrual management than for firm-years without earnings management.

#### 5.4 Test of H2

*H2* predicts that the association between forecast errors and book-tax differences is more pronounced when synthetic leases or securitizations are the likely predominant source of such differences. To test this hypothesis, I adopt the OLS model in Weber (2009) and add the sources of book-tax differences to allow book-tax differences to interact with off-balance-sheet financing. The model is specified as follows:

$$\begin{aligned}
FE_{t+1} = & \beta_0 + \beta_1 TB_t + \beta_2 AEM_t + \beta_3 TaxAvoid_t + \beta_4 OBS_t + \beta_5 TB_t * OBS_t \\
& + \beta_6 TB_t * AEM_t + \beta_7 TB_t * TaxAvoid_t + \beta_8 SIZE_t + \beta_9 MB_t + \beta_{10} \Delta FOL_{t+1} \\
& + \beta_{11} PYFE_t + \varepsilon
\end{aligned} \tag{3}$$

where  $FE$  is a firm's actual earnings in year  $t + 1$  minus the consensus forecasted earnings deflated by month 1 stock price. Consistent with Weber (2009), I measure book-tax differences ( $TB$ ) as decile rank of the ratio of net tax income to net book income scaled to vary between zero and one.  $AEM$  is an indicator variable which equals one for firm-years in the top quintile of the modified Jones model discretionary accruals of all firm-years, without synthetic leases or securitizations, and not in the  $TaxAvoid$  subsample, and zero otherwise.  $TaxAvoid$  is an indicator variable which equals one for firm-years in the lowest  $CashETRs$  quintile of all firm-years in the sample and without synthetic leases or securitizations, and zero otherwise.  $OBS$  is an indicator variable which equals one if a firm reports a securitization gain (or synthetic lease) for a year, and zero otherwise. The coefficient on the interaction  $TB * OBS$  ( $\beta_5$ ) thus represents the incremental association between forecast errors and book-tax differences for firm-years with versus those without off-balance-sheet synthetic leases or securitizations. To the extent that book-tax differences arising from off-balance-sheet financing reflect information uncertainty associated with future earnings, I expect forecast errors to be larger and thus a positive sign for  $\beta_5$ .

Following prior literature (Teoh and Wong 2002; Richardson et al. 2004; Weber 2009), I also include a number of control variables. To control for the relation between size and forecast errors as documented in prior research, I include firm size ( $SIZE$ ) measured as the natural log of market capitalization at the end of year  $t$ . Following Brown (2001), I control for growth firms using the market-to-book ratio ( $MB$ ) calculated as the

ratio of market capitalization to book value of common equity. To control for potential analyst optimistic bias, I include  $\Delta FOL$  measured as the change in the number of analysts who make earnings forecasts for a particular firm from year  $t$  to year  $t + 1$ , divided by the number from year  $t$ . I include prior year forecast errors ( $PYFE$ ) to control for the serial correlation in forecast errors as suggested in prior research (Abarbanell and Bernard 1992; Teoh and Wong 2002).  $PYFE$  is the actual earnings minus the median individual forecasted earnings from mid-year of year  $t$ , deflated by stock price. I also include *Year* and *Industry* dummies to control for year and industry effects.

### 5.5 Test of H3

Based on prior literature (e.g., Simunic 1980; Larcker and Richardson 2004; Hanlon et al. 2012), I specify the following OLS model to test whether off-balance-sheet financing affects the relation between audit fees and book-tax differences:

$$AUDFEE_t = \beta_0 + \beta_1 Ln(BTD)_t + \beta_2 OBS_t + \beta_3 TaxAvoid_t + \beta_4 ACC_t + \beta_5 Ln(BTD)_t * OBS_t + \beta_6 Ln(BTD)_t * TaxAvoid_t + \beta_7 Ln(BTD)_t * ACC_t + \beta_j \sum Controls_t + \varepsilon \quad (4)$$

where  $AUDFEE$  is the natural log of audit-related fees.  $Ln(BTD)$  is the natural log of the absolute value of total (temporary or permanent) book-tax differences.  $OBS$  is an indicator variable which equals one if a firm reports a securitization gain (or synthetic lease) for a year, and zero otherwise.  $TaxAvoid$  is an indicator variable which equals one for firm-years in the lowest  $CashETRs$  quintile of all firm-years in the sample and without synthetic leases or securitizations, and zero otherwise.  $ACC$  is an indicator variable which equals one for firm-years in the top quintile of total accruals scaled by lagged assets of all firm-years, without synthetic leases or securitizations, and not in the  $TaxAvoid$  subsample, and zero otherwise. The coefficient on  $Ln(BTD)*OBS$  ( $\beta_5$ )



represents the association between audit fees and book-tax differences for firm-years with versus those without off-balance-sheet synthetic leases or securitizations. If auditors perceive book-tax differences resulting from off-balance-sheet financing as a “red flag”, then I expect  $\beta_5$  to be positive. Consistent with Hanlon et al. (2012), I predict a positive sign for  $Ln(BTD)*ACC$  as book-tax differences arising from accrual management convey negative information about earnings quality to auditors.

Based on prior studies (e.g., Simunic 1980; Palmrose 1986; Maher et al. 1992; Craswell et al. 1995; Larcker and Richardson 2004; Hanlon et al. 2012), I include a set of control variables which proxy for cross-sectional differences in auditor and client size, audit complexity, and client risk. As audit fees increase with audit complexity and the auditor’s and client’s size, I include three measures to proxy for their effect: *BigN*,  $ln(ASSETS)$ , and *FOREIGN*. *BigN* is a dummy variable with a value of one if the firm is audited by a Big 5 (including Arthur Anderson) accounting firm for a particular year, and zero otherwise.  $ln(ASSETS)$  is the natural log of total assets and *FOREIGN* is the ratio of foreign income to total pretax book income. I include inventory (*INV*) and receivables (*REC*), both scaled by lagged assets, to control for the risk with auditing particular financial statement accounts. To control for audit risk associated with financial distress, I include three variables: *PROFIT* as measured by operating income to assets; *LOSS*, a dummy variable which equals 1 if income before extraordinary items and discontinued operations is negative in the current or prior fiscal year, and *OPINION*, which equals 1 if an audit opinion other than an unqualified opinion is given in the current year. I also include *Year* and *Industry* dummies to control for year and industry effect.

## CHAPTER VI

### EMPIRICAL RESULTS

#### 6.1 The off-balance-sheet financing sample

Table 1 reports summary statistics for firms with off-balance-sheet financing. Panel A shows characteristics of firms with securitization gains. The mean (median) value of *Assets* for the sample is \$26,815 (\$3,572) million, suggesting the firms are relatively large as compared to the overall Compustat universe mean (median) of \$4,269 (\$134.8) million during the same period. However, firm size in my sample is smaller than that reported in Dechow et al. (2010), whose sample includes a large proportion of financial firms. The amount of securitization gains varies significantly with a mean (median) value of \$87.22 (\$19.45) million. When scaled by lagged assets, the mean (median) of securitization gains is 4 (0.4) percent of lagged assets. On average, the sample firms are profitable with a median *ROA* of 3.3 percent, which is higher than the median *ROA* (1.5%) of the Compustat population. Firm growth as measured by change in sales indicates that sample firm-years have a moderate rate of growth with a mean

(median) of 16 (8.8) percent. Additionally, the sample firm-years have a relatively higher debt ratio with a median long-term debt to asset of 25.4 percent, as compared to 11.6 percent for the Compustat population for the same period.

Panel B of Table 1 presents summary information about synthetic lease firms. The mean (median) value of a synthetic lease facility in the sample is \$205 (\$100) million or 11.4 (4.7) percent of lagged assets. The actual lease amount of a firm is quite large, with a mean (median) value of \$153 (\$78) million, or 10.7 (5.2) percent of lagged assets. The mean and median size of these firms is larger than that of the Compustat universe, with mean (median) *Assets* of \$7,571 (\$1,274) million. In addition, these firms have a moderate level of debt, with a mean (median) long-term debt to asset ratio of 23.9 (21.9) percent. Further, the average sample firm is more profitable than the average Compustat firm, with a median *ROA* of 3.5 percent of lagged assets. When compared to the securitization firms, the synthetic lease firms on average are smaller and less profitable and have lower growth rates and lower levels of long-term debt.

## 6.2 Results of research question

### 6.2.1 Descriptive statistics

I use three securitizations samples and one synthetic lease sample to examine my research question.<sup>15</sup> The first sample contains only firm-years with securitization gains.

The second sample consists of firm-years in which securitizations are accounted for as

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<sup>15</sup> I partition securitization firms into these three samples because in a securitization book-tax differences are generated only when a securitization gain is recorded on book but not on tax return. If a firm accounts for its securitizations as secured borrowing or report net securitization losses, it should not report any net securitization gains for the fiscal year. Thus, I do not expect book-tax differences arise from securitizations for firm-years with net securitization losses or secured borrowing. In the matched sample approach, there is a possibility that a control firm has securitizations but does not disclose in its financial reporting. By comparing firm-years with securitization gain with those with securitization loss or secured borrowings, I can have a clean test on the effect of securitization on book-tax differences.

sales accounting. Thus, this sample contains firm-years with either securitization gains or losses. The third sample includes any firm-year with at least one securitization. In this sample, firms may account for a securitization either as sales accounting (with a gain or loss) or as secured borrowing (no gains or losses). The last sample (*Lease*) consists of any firm-year in my sample period with at least one synthetic lease and control firm-years. For each synthetic lease firm-year in this sample, I match it with a control firm-year that does not have synthetic leases or securitizations. The matching is implemented based on industry (two-digit SIC), year, and firm size.

Summary statistics for the variables used in the research question model are presented in Table 2. Panel A is based on firm-years with securitization gains. It shows a moderate level of total book-tax differences (*BTD*), with a mean (median) of 1.5 (1.3) percent of lagged assets. Panel B is based on firm-years with securitization gains and losses, which are accounted for as sales accounting. It suggests that firm-years with securitization gains (46.5%) are slightly fewer than firm-years with securitization losses (53.5%). Panel C is based on firm-years with securitizations accounted for as either sales accounting or secured borrowing. It reports that firm-years with securitization gains are about 33 percent of all securitization firm-years. For all three securitization samples, the median *BTD* is about 1 percent of lagged assets, which is between the size of book-tax differences of the small and large positive book-tax difference groups reported in Blaylock et al. (2012). The median effective cash tax rate (*CashETR*) is between 22.2 and 26.2 percent, which is below the top statutory tax rate of 35 percent, indicating that these firms are successful in avoiding taxes. Note that *CashETR* is lowest in Panel A as each firm-year in this sample reports securitization gains. This lower *CashETR* for

securitization gain years is consistent with my expectation as securitization can decrease cash effective tax rates. The mean and median discretionary accruals (*DISACC*) are less than 1 percent of lagged assets, which are comparable to those reported in Blaylock et al. (2012). Additionally, firms report profits in most of the sample years with loss years in less than 15 percent of all firm-years.

Panel D of Table 2 presents summary information about the *Lease* sample. The median *BTD* is 1.4 percent of lagged assets, which is similar to that of the securitization samples. Both the mean and median values of permanent book-tax differences (*PERM*) are larger than those of temporary book-tax differences (*TEMP*). While the mean *DISACC* is similar to that in the securitization samples, the median *DISACC* is slightly higher for the lease sample. Firm-years with a loss account for 20 percent of the sample, which is slightly more than in the securitization samples. The median value of *Growth* is 6 percent, which is comparable with the securitization samples.

Table 3 reports Pearson correlations among variables for my research question. As expected, the correlation between off-balance-sheet financing (*Secu\_Gain* or *OBS*) and *BTD* is significantly positive for all samples. Panel B suggests that securitization (*OBS*) is positively correlated with *PERM*. Panels C and D show that the correlation between off-balance-sheet financing (securitization or synthetic lease) and *TEMP* is significantly positive. For all samples, *BTD* is significantly and positively correlated with *TEMP* and *PERM* but the correlation is higher for *PERM*.

### 6.2.2 Main findings

Table 4 presents the results for my research question based on the above four

samples. Panel A shows findings for the model with total book-tax difference as the dependent variable. Consistent with my conjecture, *Secu\_Gain* or *OBS* is positively related to total book-tax difference (*BTD*) for the securitization samples (p-value < 0.05). *OBS* is also positively associated with *BTD* for the lease sample (p-value < 0.01). Further, the coefficient on *OBS* is much greater for the lease sample (0.392) than for the securitization samples (between 0.01 and 0.02). This result suggests that synthetic leases seem to have a larger effect on book-tax differences than securitizations. For control variables, *DISACC* is significantly and positively associated with *BTD* (p-value < 0.01), indicating that accruals increase with book-tax differences. Consistent with my expectation, the coefficient on *CashETR* is significantly and negatively associated with *BTD*, but for only one of the securitization samples. Additionally, the coefficient on  $\Delta NOL$  is negative and significant across all samples, suggesting that firms with net operating loss carryforwards have less incentive to avoid tax compared to firms without net operating losses. The findings also show a positive association between the presence of foreign operations and intangible assets and *BTD* for some samples. Contrary to my expectation, *LOSS* is positively related to *BTD* for all samples. This positive sign may be due to the presence of both *LOSS* and  $\Delta NOL$  in the model. As net operating loss carryforwards from prior year can result in a loss in current year, the effect of *LOSS* on *BTD* may be offset by  $\Delta NOL$ .

Panel B of Table 4 presents findings with temporary book-tax difference as the dependent variable. Unlike the results in Panel A, *Secu\_Gain* is not significant at conventional level and *OBS* is significantly and positively associated with temporary book-tax difference (*TEMP*) only for the lease sample. For control variables, *DISACC*

remains significant and positive for all but the one securitization sample, but the coefficient is smaller than that reported in Panel A. *CashETR* exhibits the expected negative sign and is significant for the lease and one securitization sample. *LAGTEMP* is significant throughout all samples. Overall, the adjusted R-squared in Panel B is smaller than that in Panel A.

Panel C of Table 4 shows findings with permanent book-tax difference as the dependent variable. *Secu\_Gain* is positively associated with permanent book-tax difference (*PERM*) (p-value < 0.1) and *OBS* is significant only for the lease sample (p-value < 0.01). The significant association between off-balance-sheet financing and permanent book-tax differences seems surprising at first given that securitizations and synthetic leases are expected to generate only temporary book-tax differences. However, one has to acknowledge that the measure of permanent book-tax differences, *PERM*, is not perfect. It includes permanent differences, tax accruals (e.g., tax contingency reserves), and tax credits (reduce current tax expenses). Blouin and Tuna (2009) note that interest and potential penalties related to timing differences between book and tax income are often reported in tax contingency reserves in the pre-FIN 48 periods. Based on their calculation of tax reserve, a decrease cash tax paid in the current year increases tax reserve.<sup>16</sup> It is possible that securitization and synthetic leases may increase *PERM* through their effects on tax reserve.<sup>17</sup> Similar to the result in Panel A, *DISACC* is positive and significant across samples.

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<sup>16</sup> Blouin and Tuna (2009) measure change in tax reserve using current tax expense to subtract cash tax paid, estimated tax benefit from stock options, and change in income taxes payable.

<sup>17</sup> First, securitizations and synthetic leases may reduce cash tax paid for earlier years of the securitization (lease) due to the differences between financial and tax reporting rules. Additionally, the interest on the timing differences could be substantial given the size of the gains (or leases) and the life of securitized (or leased) asset.

## 6.3 Results of H1

### 6.3.1 Descriptive statistics

Table 5 presents descriptive statistics related to H1 for firms with positive total (temporary or permanent) book-tax differences. Panels A through C of Table 5 report summary information using the securitization matched sample. The number of securitization firms is slightly smaller than the number of control firms in each of the samples. The summary statistics are qualitatively similar across the three samples. Firms in the positive temporary book-tax differences sample, on average, are larger than firms in the other two samples. Panels D through F report descriptive statistics for the securitization *S&P* samples. In the three sample partitions, securitization firms account for about 2 to 3 percent of the total firm-years in the sample. Similarly, firms in the positive temporary book-tax differences sample have larger size than firms in the other two samples, while other statistics are similar across samples. Panels G through I show summary statistics for the lease matched sample. The sample size is generally larger than the securitization matched sample. Pre-tax book income (*PTBI*) is slightly larger and effective cash tax rate (*CashETR*) is slightly smaller in the positive total book-tax differences sample than in the other two samples. Panels J through L present summary statistics for the lease *S&P* sample. Firm-years with synthetic leases account for about 6 to 7 percent of the sample. Panels M through O report summary statistics for the securitization and lease combined matched sample. Panels P through R report summary statistics for the securitization and lease combined *S&P* samples.

Note that firm size in terms of median assets in all the matched samples is larger than that in Blaylock et al. (2012), suggesting firms using off-balance-sheet financing



tend to be medium to large size. In all sample partitions, the mean (median) *PTBI* is above 8 (7) percent of lagged assets indicating that on average the sample firms are profitable. Similar to the positive *BTD* groups reported in Blaylock et al. (2012), the mean and median discretionary accruals (*DISACC*) are positive in all sample partitions. *CashETR* is similar across sample partitions with a median value ranging from 24.2 to 27.1 percent.

### 6.3.2 Main findings

In this subsection, I examine the effect of off-balance-sheet financing on earnings persistence through book-tax differences. As prior research (e.g., Hanlon 2005, Blaylock et al. 2012) investigates firms with positive temporary book-tax differences, my main focus is on samples based on temporary book-tax differences. Panel A of Table 6 reports results using the securitization samples. Columns (1) through (3) are based on the securitization matched samples and Columns (4) through (6) are based on the securitization *S&P* sample. Similar to prior studies (e.g., Hanlon 2005, Blaylock et al. 2012), the coefficient on *PTBI* is significant and positive in all sample partitions. The coefficient on the off-balance-sheet financing dummy (*OBS*) is not significant across the sample partitions. Further, the coefficient on the interaction between earnings and securitization (*PTBI\*OBS*) is not significant across sample partitions. This result is inconsistent with H1, suggesting that earnings persistence is not significantly lower for firm-years with book-tax differences arising from securitizations than for firm-years in the *Control* subsample. The insignificant coefficient on *OBS* and *PTBI\*OBS* indicates

that securitizations have no significant effect on earnings persistence.<sup>18</sup> Consistent with prior research, I find that  $PTBI * AEM$  is significantly negative for two of the *S&P* samples.

Panel B of Table 6 reports results for the synthetic lease samples. Columns (1) through (3) are based on the matched samples and Columns (4) through (6) are based on the *S&P* samples. Similar to findings for securitizations, the coefficient on  $PTBI$  is significant and positive in all sample partitions. The coefficient on interaction  $PTBI * OBS$  is significant and negative for the matched and *S&P* samples with positive temporary book-tax differences. This finding offers support to H1, suggesting that earnings are less persistent for firms with positive book-tax differences likely arising from synthetic leases. I also find that for firm-years with positive permanent book-tax differences,  $PTBI * OBS$  is significantly negative for the matched sample. Additionally, similar to the finding in Blaylock et al. (2002), the coefficient on  $PTBI * AEM$  is significant and negative for the lease *S&P* samples. I also find that the coefficient on  $PTBI * TaxAvoid$  is significant and negative in the matched sample with positive temporary book-tax differences and in all lease *S&P* samples. This finding suggests that, for synthetic lease firms, each of the three sources of book-tax differences could contribute to lower earnings persistence as compared to book-tax differences arising from other sources.

Panel C of Table 6 presents results using the securitization and lease combined samples. Columns (1) through (3) are based on the combined matched sample and

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<sup>18</sup> Prior research (e.g., Dechow et al. 2010) shows that firms have incentives to engage in securitizations for the purpose of earnings management. Given this empirical evidence, earnings persistence is expected to be negatively associated with securitizations. However, there exists much difference in samples used in prior study and my study. The sample in Dechow et al. (2010) mainly consists of financial service firms while my sample excludes financial firms. Further, 76 percent of firm-years in their sample report a gain while in my study only 46.5 percent firm-years have a gain in the sample with only securitization gains and losses.

Columns (4) through (6) are based on the combined *S&P* sample. Similar to the results reported in Panels A and B, the coefficient on *PTBI* is significant in all sample partitions. In the *S&P* sample with positive temporary book-tax differences, I find that the coefficient on *PTBI\*OBS* is negative (p-value < 0.05). For this sample, *PTBI\*AEM* is significant while *PTBI\*TaxAvoid* is not significant at conventional levels. This finding is consistent with Blaylock et al. (2012), who show that earnings are less persistent for firms with positive temporary book-tax differences resulting from earnings management as compared to tax avoidance. In the other sample partitions, the coefficient on *PTBI\*OBS* is not significant.

In summary, the findings from Table 6 suggest that earnings exhibit lower persistence for firms with positive temporary book-tax differences likely arising from synthetic leases but not from securitizations.

## 6.4 Results of H2

### 6.4.1 Descriptive statistics

Table 7 reports summary statistics for the dependent and independent variables in the OLS regression. Panels A and B present summary data for the securitization matched and *S&P* sample, respectively. Panels C and D present summary statistics for the lease matched and *S&P* samples, respectively. Panels E and F report summary information for the securitization and lease combined control and *S&P* sample, respectively. Consistent with forecast optimism reported in prior research (e.g., Bradshaw et al. 2001), the mean forecast errors (*FE*) is negative. The mean net tax income to net book income (*TB*) is close to its median for all samples. The market to book ratio (*MB*) is higher in the lease

samples than in the securitization sample, indicating that firms with synthetic leases have higher growth opportunity than firms with securitizations.

Table 8 reports the Pearson correlation matrix. Consistent with prior studies, *FE* is positively correlated with *MB* (Brown 2001), *SIZE* (Richardson et al. 2004), and change in analysts following ( $\Delta FOL$ ) (Teoh and Wong 2002) in the majority of the samples, and is positively correlated with *PYFE* (Abarbanell and Bernard 1992) in all samples. Similar to Weber's (2009) findings, *FE* is positively correlated with *TB* but only for the *S&P* samples. For all samples, *FE* is not significantly correlated with *OBS*. Additionally, *FE* is not significantly correlated with *AEM* or *TaxAvoid* except for the lease *S&P* sample.

#### 6.4.2 Main findings

H2 predicts that forecast errors are larger for firms with book-tax differences arising from off-balance-sheet financing. Table 9 presents the results for H2. Consistent with Webber (2009), the coefficient on *TB* is significant and positive in the *S&P* samples. This suggests that analysts fail to fully reflect information contained in book-tax differences in their forecasted earnings. All control variables have expected signs with *SIZE* and *MB* being significant for only half of the samples. The interaction between book-tax differences and off-balance-sheet financing ( $TB*OBS$ ) is not significant across samples. Further,  $TB*AEM$  and  $TB*TaxAvoid$  are also insignificant across samples except for  $TB*TaxAvoid$  in the lease matched sample. This result suggests that the documented forecast errors related to book-tax differences are not due to any particular source of such differences. In other words, analysts seem to ignore the information in book-tax differences no matter what the source of such differences may be. This finding is

surprising given that recent empirical evidence (e.g., Blaylock et al. 2012) suggests that different sources of book-tax differences may have different implications for future earnings.

In summary, the findings in Table 9 shows that the relation between forecast errors and book-tax differences is not significantly more pronounced when firms engage off-balance-sheet financing. It appears that the systematic BTD-related forecast errors as documented in Webber (2009) are not driven by any particular source of book-tax differences.

## 6.5 Results of H3

### 6.5.1 Descriptive statistics

Table 10 presents descriptive statistics for dependent and independent variables in H3. The mean (median) value of *ASSETS* is above 7.51 (7.35) which is higher than that in Hanlon et al. (2012) and the overall Compustat population mean (median) of 5.22 (5.45). Consequently, the median audit fees for the combined matched and *S&P* samples are about \$990,700 and \$2,575,000, respectively. These numbers are much larger than the median audit fees (\$191,000) reported in Hanlon et al. (2012). Consistent with the size of the sample firms, Table 10 shows that a much higher percentage of firms is audited by *BigN* firms (>97%), and a very low proportion of firms has an audit opinion other than an unqualified opinion (<1%), as compared to 79 percent and 39 percent in Hanlon et al. (2012), respectively.

Table 11 reports Pearson correlations among the dependent and independent variables. Panels A through F show that total book-tax difference (*ABSBTD*) is

significantly correlated with both temporary and permanent book-tax differences (*ABSTEMP* and *ABSPERM*, respectively). Consistent with Hanlon et al. (2012), audit fees (*AUDFEE*) are positively and significantly correlated with *ABSBTD*, *ABSTEMP* and *ABSPERM* in all samples. In addition, *AUDFEE* is positively and significantly correlated with *AEM*. However, *OBS* is not positively and significantly correlated with *AUDFEE* for all samples. Further, for half of the samples, *TaxAvoidance* is negatively correlated with *AUDFEE*. Not surprisingly,  $\ln(\text{ASSETS})$ , receivables (*REC*), and *BigN* are positively correlated with *AUDFEE*. However, inventory (*INV*) is shown negatively correlated with *AUDFEE* for four out of the six sample partitions.

#### 6.5.2 Main findings

H3 predicts that the association between audit fees and book-tax differences increases with the use of off-balance-sheet financing. Panel A of Table 12 presents findings for H3 based on total book-tax differences. Consistent with Hanlon et al. (2012), the coefficient on *ABSBTD* is significant and positive for all but the lease samples, confirming the positive association between audit fees and book-tax differences. For the lease *S&P* and combined *S&P* samples, the coefficient on the interaction *ABSBTD\*OBS* is significantly negative with a value of -0.07 (p-value < 0.1). For other samples, the coefficient on *ABSBTD\*OBS* is insignificant. The coefficient on *OBS* is significantly positive for the combined *S&P* sample with a value of 0.33 (p-value < 0.1). The sum of coefficients *OBS + ABSBTD\*OBS* is also positive (p-value < 0.1), suggesting that audit fees on average increase for firms with off-balance-sheet financing based on the combined *S&P* sample. Taken together, the results suggest that the positive association

between audit fees and book-tax differences is not mainly driven by off-balance-sheet financing.

Panel B of Table 12 reports findings of H3 using temporary book-tax differences. I find that the coefficient on *TEMP* is significant and positive for the securitization matched sample. For the lease *S&P* sample, I find that the coefficient on *ABSTEMP\*OBS* is significantly negative with a value of -0.116 (p-value <0.05) while *OBS* is significantly positive with a value of 0.367 (p-value <0.01). The sum of coefficients *OBS* + *ABSTEMP\*OBS* is positive and significant (p-value < 0.05), indicating a positive association between audit fees and off-balance-sheet financing. For other samples, the coefficients on *TEMP\*OBS* and *OBS* are not significant.

Panel C of Table 12 shows the findings of H3 using permanent book-tax differences. Consistent with Hanlon et al. (2012), I find that the coefficient on *PERM* is significant and positive, except in the lease matched sample. Similar to the evidence provided by Panels A and B, the coefficient on *PERM\*OBS* is significantly negative (p-value < 0.05), while *OBS* is significantly positive with a much larger value (p-value < 0.05) for the securitization matched and lease *S&P* samples. Again, the sum of coefficients *OBS* + *ABSPERM\*OBS* is significantly positive (p-value < 0.05).

Based on the evidence above, it appears that off-balance-sheet financing is priced in audit fees but does not affect the positive relation between audit fees and book-tax differences. A possible explanation is that auditors, unlike outside parties such as security analysts, have a much broader access to a company's financial and nonfinancial information. Auditors are more aware of whether a company engages in off-balance-sheet transactions than outside parties (at least after the first year). Consequently, auditors are

likely to evaluate the implications of these transactions on financial statements and incorporate the information into their audit fee decisions. Due to the complexity and potential risks associated with these transactions, auditors may charge a higher fee for a company with securitizations or synthetic leases than they would for other clients, given that all other factors are equal. However, information contained in book-tax differences may or may not be relevant in this decision making as the auditor can assess the financial statement impact of these off-balance-sheet transactions from direct sources.

Unlike Hanlon et al. (2012), I do not find that the positive association between audit fees and book-tax differences is stronger for firms with high accruals. The control variables have expected signs and are significant in the majority of the samples, with two exceptions: *BigN* is insignificant, and *INV* is either insignificant or negative.<sup>19</sup>

Overall, I do not find evidence to support the prediction in H3. The association between audit fees and book-tax differences does not appear to be driven by off-balance-sheet financing.

## 6.6 Additional analyses

### 6.6.1 Ranked securitization gains

For H2 and H3, I use a dummy variable to proxy for securitizations or synthetic leases. As the magnitude of securitization gains contains more information compared to the dummy variable, I construct a variable based on ranked securitization gains, *OBSrank*, to re-run those tests. *OBSrank* is the quintile rank securitization gains scaled by lagged assets.

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<sup>19</sup> Note that *OPINION* is dropped from regression for the lease S&P samples due to its limited variation.



Table 13 reports findings for H2 using *OBSrank*. The results are very close to the findings reported in Columns (1) and (2) of Table 9. Net tax income to net book income (*TB*) is significant for the *S&P* sample but the interaction *TB\*OBSrank* is not significant at conventional levels.

Table 14 presents results for H3 using *OBSrank* for the three types of book-tax differences. The variable which measures book-tax differences (*ABSBTD*, *ABSTEMP*, and *ABSPERM*) is positive and significant except for one sample. Panel C shows that the coefficient on the interaction *ABSPERM\*OBSrank* is significant and negative for the *S&P* sample. Similar to the findings in Table 12, the coefficient on *OBSrank* is positive (p-value <0.05) and larger than that on *ABSPERM\*OBSrank* for the *S&P* sample, again suggesting that audit fees increase with off-balance-sheet financing but not through book-tax differences.

#### 6.6.2 Alternative measure of *CashETR*

*CashETR* can potentially offset the effect of off-balance-sheet financing on book-tax differences when both cash effective tax rates and off-balance-sheet financing are independent variables in model (1). To overcome this potential problem, I construct an alternative measure of *CashETR* (*CashETR\_Alt*) by regressing cash effective tax rates on off-balance-sheet financing and using the residual as a proxy for tax avoidance. The residual thus represents *CashETRs* not generated by off-balance-sheet financing. Table 15 reports findings based on this alternative measure *CashETR*. The findings are qualitatively similar to those based on *CashETR* in Table 4 for my research question.

### 6.6.3 Alternative measure of accruals

Following Weber (2009), I also use an alternative accrual measure in the forecast error tests.<sup>20</sup> The result (untabulated) based on this alternative accrual measure does not change my inference made for H2.

### 6.6.4 Scaling effect

I use lagged assets as scalar for the research question and H1. Alternatively, I use average assets to replace lagged assets as scalar. The findings do not qualitatively change using this alternative scalar.

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<sup>20</sup> This accrual measure is calculated as  $(\Delta\text{Current Assets} - \Delta\text{Cash}) - (\Delta\text{Current Liabilities} - \Delta\text{Debt included in current liabilities}) - \Delta\text{Deferred Tax Liability} - \text{Depreciation}$ , scaled by average assets.

## CHAPTER VII

### CONCLUSION

This paper first investigates whether off-balance-sheet financing affects book-tax differences after controlling for other sources of book-tax differences. Using samples of securitizations and synthetic leases, I find a positive and significant relation between off-balance-sheet financing and book-tax differences. The magnitude of the effect of off-balance-sheet financing on book-tax differences is approximately between 1-2 percent for securitizations and 40 percent for synthetic leases. Prior studies (e.g., Mills et al. 2002; Plesko 2002 and 2004) find an increasing gap between book income and taxable income in the 1990s, and researchers conjecture that off-balance-sheet financing could be a contributing factor of this increased gap (Mills et al. 2002). My findings offer empirical evidence to support this conjecture, showing that off-balance-sheet financing is positively associated with book-tax differences. Additionally, I quantify the magnitude of the effect of off-balance-sheet financing on book-tax differences.

Next, I test three hypotheses on the effect of off-balance-sheet financing on the relation between book-tax differences and firm attributes, including earnings persistence, analyst forecast errors, and audit fees. For the first hypothesis, I find evidence suggesting that lower earnings persistence is associated with positive temporary book-tax differences arising from synthetic leases and securitizations. This result further explains the negative association between earnings persistence and book-tax differences shown by Hanlon (2005) and Blaylock et al. (2012). It also complements the findings in Blaylock et al. (2012) who suggest that book-tax differences likely arising from upward earnings management contribute to the negative association between earnings persistence and book-tax differences. The results from my study indicate that for firms with off-balance-sheet financing such as synthetic leases and securitizations, positive book-tax differences may be associated with lower future earnings.

For my second hypothesis, I examine the relation between analyst forecast errors and book-tax differences arising from off-balance-sheet financing. Similar to Weber (2009), I find evidence that book-tax differences are positively related to forecast errors. However, I do not find a significant association between forecast errors and book-tax differences arising from off-balance-sheet financing. Further, my findings indicate no significant relation between forecast errors and book-tax differences arising from earnings management or tax avoidance. It appears that analysts' failure to incorporate information contained in book-tax differences is not driven by any particular source of such differences.

In my final hypothesis, I examine the effect of off-balance-sheet financing on the relation between audit fees and book-tax differences. I find that the positive association

between these variables is not driven by off-balance-sheet financing. As auditors may be aware of a firm's use of off-balance-sheet financing from other sources, book-tax differences by themselves do not appear to provide additional information about off-balance-sheet securitizations or synthetic leases for audit fee decisions.

This study is important in several ways. First, prior literature suggests book-tax differences could result from earnings management, tax avoidance, or off-balance-sheet financing activities (e.g., Mills 1998; Phillips et al. 2003; Dhaliwal et al. 2004; Mills and Newberry 2005; Wilson 2009). However, extant literature has not directly tested the implication of off-balance-sheet financing for book-tax differences or systematically examined how these potentially correlated sources affect such differences. Findings from this study may shed light on the effect of off-balance-sheet financing on book-tax differences. Additionally, my study also contributes to literature on the economic consequences of off-balance-sheet financing by providing evidence of the effect of off-balance-sheet financing on relation between earnings persistence and book-tax differences. Finally, my study adds to the existing literature on accounting issues related to balance-sheet financing. Specifically, I provide evidence to answer Hanlon and Heitzman's (2010) call for research on the tax implications of complex financial instruments.

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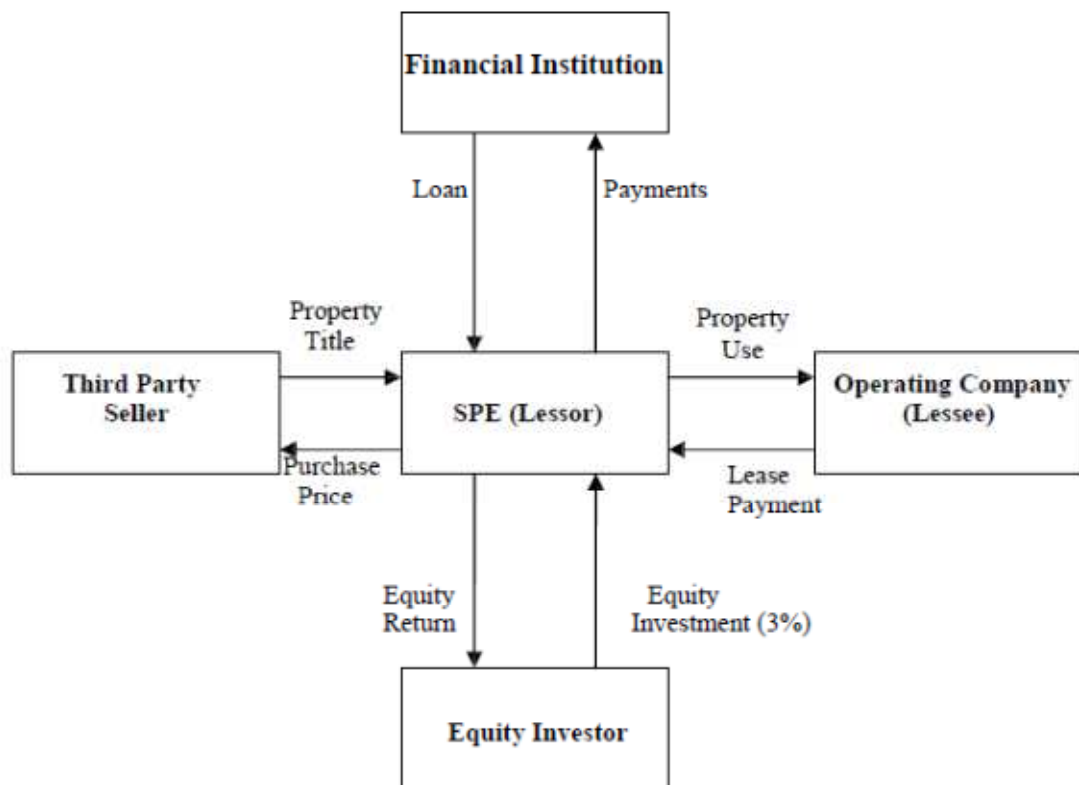
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## APPENDICES

### Appendix A. The structure of a typical synthetic lease

This appendix illustrates a typical synthetic lease structure - adapted from Little (2002).



## APPENDIX B. Examples of synthetic lease disclosures

### Ebay (2001 10-K)

On March 1, 2000, we entered into a five-year lease for general office facilities located in San Jose, California. This five-year lease is commonly referred to as a synthetic lease because it represents a form of off-balance sheet financing under which an unrelated third-party funds 100% of the costs of the acquisition of the property and leases the asset to us as lessee. Under our lease structure, upon termination or expiration, at our option, we must either purchase the property from the lessor for a predetermined amount or sell the real property to a third-party.

Payments under our lease are based on the \$126.4 million cost of the property funded by the third-party and are adjusted as the London Interbank Offering Rate (“LIBOR”) fluctuates. Under the terms of the lease agreement, the lease terminates on March 1, 2005, unless extended to September 1, 2006. At any time prior to the final 12 months of the lease term, we may, at our option, purchase the property for approximately \$126.4 million. If we elect not to purchase the property, we will undertake to sell the facility to one or more third parties and have guaranteed to the lessor a residual value equal to approximately 88% of the \$126.4 million cost of the property. We may also be liable to the lessor for the entire amount of \$126.4 million if we default on any of certain lease obligations and financial covenants. If this payment were made, we would then receive title to the property. At December 31, 2001, we had not made a decision with respect to the option we will pursue at the end of the lease term, although it is likely that we will decide to continue to occupy the property. Management believes that the contingent liability relating to the residual value guarantee will not have a material adverse effect on our financial condition or results of operations.

If our lease were terminated, and we became obligated to pay the purchase price of the land and buildings, we would show the cost as an asset on our balance sheet and our restricted cash and investments position would be reduced by the amount of the purchase price. Currently, we reflect rent payments as an expense on our statement of income. In the event we were required to purchase the land and buildings, our rent expense would cease and we would subsequently record depreciation expense for the buildings over their estimated useful lives.

### AT&T Wireless Services (2003 10-K)

As a result of the adoption of FIN 46, AT&T Wireless Services consolidated these entities at their carrying values effective April 1, 2003. Additionally, AT&T Wireless Services has determined it has a significant variable interest and is deemed to be the primary beneficiary in an entity that holds assets and liabilities associated with synthetic leases. As a result, upon adoption, AT&T Wireless Services consolidated the assets and liabilities associated with two synthetic leases that were previously disclosed as off-balance sheet arrangements.

## Appendix C. Examples of securitization disclosures

### 1. Saks Inc (2000 10-K)

All accounts receivable generated by the Company's proprietary credit cards are sold to wholly owned special purpose subsidiaries of the Company. The special purpose subsidiaries transfer the receivables, with limited recourse, to either a credit card related trust or a bank conduit facility in exchange for cash and subordinated certificates representing undivided interests in the pool of receivables. These facilities subsequently issue certificates of beneficial interest, also representing undivided interests in the pool of receivables, to investors. At January 29, 2000, the funding capacity consisted of approximately \$1.3 billion of which \$897.2 million were fixed rate certificates and \$400.0 million were variable rate certificates...Gains on sales of accounts receivable included within net finance charge income were \$19,500, \$36,400 and \$15,000 in 1999, 1998 and 1997 respectively.

### 2. J. Crew Group Inc (2000 10-K)

In October 1997, the Company entered into an agreement to securitize certain customer installment receivables of Popular Club Plan, Inc. on a revolving basis. The Company had no obligation to reimburse the trust or the purchasers of beneficial interests for credit losses. The transactions were accounted for as a sale in accordance with the provisions of SFAS No. 125 "Accounting for Transfers and Servicing of Financial Assets and Extinguishment of Liabilities." Under SFAS No. 125, no servicing asset or liability was recorded as fees charged were expected to cover related expenses.

At January 31, 1998, \$46,000,000 of accounts receivable had been sold pursuant to this agreement. The sale of receivables resulted in a gain of \$1,472,000 during the year ended January 31, 1998. Finance charge income, including the gain on sale, was \$5,325,000 and \$8,294,000 for fiscal years 1998 and 1997.



APPENDIX D. Variable definitions

<i>Dependent Variables:</i>	
<i>BTD</i>	The total book-tax difference, which equals book income less estimated taxable income scaled by average book assets (COMPUSTAT item 6). Book income is pretax income (item 170). Estimated taxable income is calculated by summing the current federal tax expense (item 63) and current foreign tax expense (item 64) and dividing by the 35% statutory tax rate ( <i>STR</i> ) and then subtracting the change in NOL carryforwards (item 52). If current the federal tax expense is missing, the total current tax expense is calculated by subtracting deferred taxes (item 50), state income taxes (item 173), and other income taxes (item 211) from the total income taxes (item 16).
<i>PERM</i>	Permanent book-tax difference equals <i>TOTALBTD</i> less <i>TEMPBTD</i> .
<i>TEMP</i>	Temporary book-tax difference, which is the sum of U.S (item 269) and foreign (item 270) deferred tax divided by the 35% statutory rate and then scaled by lagged total assets (item 6).
<i>Lead_PTBI</i>	Pre-tax book income (item 170) of next year deflated by current assets (item 6).
<i>FE</i>	A firm's actual earnings in year $t + 1$ minus the consensus forecasted earnings deflated by stock price.
<i>AUDFEE</i>	The natural log of audit-related fees.
<i>Independent Variables:</i>	
<i>CashETR</i>	Five-year effective cash tax rate, which equals sum of cash taxes paid (COMPUSTAT item 317) over the previous 5 years divided by the sum of pretax income (item 170 - item 17) over the previous 5 years (or 3 years if 5 years of data are unavailable). <i>CashETRs</i> greater than one are dropped. Negative <i>CashETR</i> are reset to 0.
<i>Secu_Gain</i>	The value of securitization gains scaled by lagged assets.
<i>OBS</i>	An indicator variable which equals one if a firm reports a securitization gain (or synthetic lease) for a year, and zero otherwise.
<i>DISACC</i>	Discretionary accruals measured as the residual from the modified Jones model
<i>Loss</i>	An indicator variable which equals one if a firm reports negative pretax income and zero otherwise (item 170 - item 17).
<i>Growth</i>	The change in net sales (item 12).
<i>ANOL</i>	The change in net operating loss carryforward (item 52).
<i>NPPE</i>	The ratio of net property, plant and equipment (item8) to gross property, plant and equipment (item 7).
<i>Intang</i>	Goodwill (item 204) and other intangibles (item 33).
<i>Equity</i>	Income or loss attributable to the equity method (item 55).

<i>MI</i>	Income or loss attributable to minority interests (item 49).
<i>LAGBTD</i>	The lagged <i>BTD</i> .
<i>LAGTEMP</i>	The lagged <i>TEMP</i> .
<i>LAGPERM</i>	The lagged <i>PERM</i> .
<i>PTBI</i>	Pre-tax book income (item 170) deflated by lagged assets (item 6).
<i>TaxAvoid</i>	An indicator variable which equals one for firm-year observations within the positive total (temporary or permanent) book-tax differences group and with <i>CashETRs</i> in the lowest quintile of all firm-years in the sample and not in the <i>OBS</i> subsample, and zero otherwise.
<i>AEM</i>	An indicator variable which equals one for firm-year observations within the positive total (temporary or permanent) book-tax differences group and with modified Jones model discretionary accruals in the top quintile of all firm-years and not in the <i>OBS</i> or <i>TaxAvoid</i> subsample, and zero otherwise.
<i>PTBI*OBS</i>	The interaction between <i>PTBI</i> and <i>OBS</i> .
<i>PTBI*TaxAvoid</i>	The interaction between <i>PTBI</i> and <i>TaxAvoid</i> .
<i>PTBI*AEM</i>	The interaction between <i>PTBI</i> and <i>AEM</i> .
<i>TB</i>	Decile rank of the ratio of net tax income to net book income scaled to vary between zero and one. Net tax income is measured as $(TAX/STR) * (1 - STR)$ , where <i>STR</i> is the top U.S. statutory corporate tax rate and <i>TAX</i> is current tax expense. <i>TAX</i> is measured as the sum of current federal (COMPUSTAT item 63) and foreign (item 64) income taxes, or, when either of these amounts is missing, as total income tax expense (item 16) less deferred tax expense (item 50). Net book income is earnings before extraordinary items (item 18).
<i>TaxAvoid</i>	An indicator variable which equals one for firm-year observations with <i>CashETRs</i> in the lowest quintile of all firm-years in the sample and not in the <i>OBS</i> subsample, and zero otherwise.
<i>AEM</i>	An indicator variable which equals one for firm-year observations with modified Jones model discretionary accruals in the top quintile of all firm-years and not in the <i>OBS</i> or <i>TaxAvoid</i> subsample, and zero otherwise.
<i>TB*OBS</i>	The interaction between <i>TB</i> and <i>OBS</i> .
<i>TB*AEM</i>	The interaction between <i>TB</i> and <i>AEM</i> .
<i>TB*TaxAvoid</i>	The interaction between <i>TB</i> and <i>TaxAvoid</i> .
<i>SIZE</i>	The natural log of market capitalization ( <i>CAP</i> ) measured at year end (item 199 × item 54).
<i>MB</i>	The ratio of <i>CAP</i> to book value of common equity (item 216).
$\Delta FOL$	The change in the number of analysts who make earnings forecasts for a particular firm from year <i>t</i> to year <i>t</i> + 1, divided

	by the number from year $t$ .
<i>PYFE</i>	The actual earnings minus the median individual forecasted earnings from mid-year of year $t$ , deflated by stock price.
<i>ABSBTD</i>	The natural log of the absolute value of total book-tax differences.
<i>ABSTEMP</i>	The natural log of the absolute value of temporary book-tax differences.
<i>ABSPERM</i>	The natural log of the absolute value of permanent book-tax differences.
<i>ACC</i>	An indicator variable which equals one for firm-years in the top quintile of total accruals scaled by lagged assets, without synthetic leases or securitizations, and not in the <i>TaxAvoid</i> subsample, and zero otherwise. Total accruals are the difference between earnings (item 18) and cash flows from operations (item 308) scaled by lagged assets (item 6).
<i>TaxAvoid</i>	An indicator variable which equals one for firm-years in the lowest <i>CashETRs</i> quintile in the sample, without synthetic leases or securitizations, and not in the <i>ACC</i> subsample, and zero otherwise.
<i>BigN</i>	A dummy variable with a value of one if the firm is audited by a Big 5 (including Arthur Anderson) accounting firm in the current fiscal year, and zero otherwise.
<i>Ln(ASSETS)</i>	The natural log of total assets (item 6).
<i>FOREIGN</i>	The ratio of foreign pre-tax income (item 273) to total pre-tax income (item 170).
<i>ABSBTD (ABSTEMP, ABSPERM)*OBS</i>	The interaction between <i>ABSBTD (ABSTEMP or ABSPERM)</i> and <i>OBS</i> .
<i>ABSBTD (ABSTEMP, ABSPERM)*AEM</i>	The interaction between <i>ABSBTD (ABSTEMP or ABSPERM)</i> and <i>AEM</i> .
<i>ABSBTD (ABSTEMP, ABSPERM)*TaxAvoid</i>	The interaction between <i>ABSBTD (ABSTEMP or ABSPERM)</i> and <i>TaxAvoid</i> .
<i>INV</i>	The total value of inventory (item 3) scaled by assets (item 6).
<i>REC</i>	The total value of receivables (item 2) scaled by assets (item 6).
<i>PROFIT</i>	Firm profit which is measured by operating income (item 178) scaled by assets (item 6).
<i>LOSS</i>	A dummy variable which equals 1 if income before extraordinary items and discontinued operations (item 18 - item 66) is negative in the current or prior fiscal year, and 0 otherwise.
<i>OPINION</i>	A dummy variable which equals 1 if an audit opinion other than an unqualified opinion is given in the current year, and 0 otherwise.
<i>OBSrank</i>	The quintile rank securitization gains scaled by lagged assets.

<i>CashETR_Alt</i>	The residual from the regression in which <i>CashETR</i> is regressed on <i>Secu_Gain</i> .
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TABLE 1

Descriptive Statistics of Firms with Securitization Gains or Synthetic Leases

Panel A: Securitization firms with securitization gains

Variable	N	Mean	Std. Dev.	Lower Quartile	Median	Upper Quartile
<i>Assets</i>	292	26,815	92,602	1,359	3,572	14,019
<i>Gains</i>	292	87.22	240.405	6.35	19.45	57.2
<i>Gains/Assets</i>	292	0.04	0.181	0.001	0.004	0.02
<i>ROA</i>	292	0.039	0.069	0.009	0.033	0.066
<i>Growth</i>	292	0.16	0.491	0.009	0.088	0.184
<i>Long-term Debt</i>	292	0.272	0.206	0.144	0.254	0.362

Panel B: Synthetic lease firms

variable	N	Mean	Std. Dev.	Lower Quartile	Median	Upper Quartile
<i>Facility</i>	111	205.45	376.128	59.8	100	197
<i>Lease Amount</i>	200	153.322	291.876	42	78	157.98
<i>Assets</i>	367	7,571	31,858	630	1,274	4,615
<i>ROA</i>	367	0.018	0.139	-0.017	0.035	0.084
<i>Growth</i>	367	0.111	0.494	-0.032	0.067	0.219
<i>Long-term Debt</i>	367	0.239	0.217	0.048	0.219	0.34

This table reports firm properties for firms engaged in off-balance-sheet financing. Panel A presents summary information for firms with securitization gains and Panel B presents information for firms with synthetic leases. *Assets* is total assets (Compustat item data6). *Gains* is the amount of securitization gains. *Gains/Assets* is securitization gains scaled by lagged assets. *ROA* is return on assets, measured by net income scaled by lagged assets. *Growth* is change in net sales divided by lagged net sales. *Long-term Debt* is long-term debt scaled by lagged assets. *Facility* is the size of a synthetic lease facility. *Lease Amount* is the size of a synthetic lease.

TABLE 2

Descriptive Statistics for Research Question

Panel A: Firms with only securitization gains

Variable	N	Mean	Std. Dev.	Lower Quartile	Median	Upper Quartile
<i>BTD</i>	292	0.015	0.075	-0.009	0.013	0.036
<i>TEMP</i>	292	0.006	0.031	-0.007	0	0.021
<i>PERM</i>	292	0.009	0.074	-0.002	0.004	0.022
<i>Secu_Gain</i>	292	0.039	0.184	0.001	0.004	0.018
<i>LOSS</i>	292	0.11	0.313	0	0	0
<i>Growth</i>	292	0.16	0.491	0.009	0.088	0.184
<i>ΔNOL</i>	292	0.007	0.069	0	0	0
<i>NPPE</i>	292	0.576	0.141	0.469	0.556	0.682
<i>Intang</i>	292	0.216	0.312	0.022	0.089	0.339
<i>MI</i>	292	0	0.002	0	0	0
<i>FOREIGN</i>	292	-0.268	5.674	0	0	0.215
<i>Equity</i>	292	0	0.004	0	0	0
<i>DISACC</i>	292	0.005	0.112	-0.025	0.005	0.035
<i>CashETR</i>	277	0.137	0.904	0.081	0.222	0.324

Panel B: Firms with securitization gains or losses

Variable	N	Mean	Std. Dev.	Lower Quartile	Median	Upper Quartile
<i>BTD</i>	551	0.005	0.081	-0.012	0.011	0.034
<i>TEMP</i>	551	0.004	0.032	-0.008	0.003	0.017
<i>PERM</i>	542	0.001	0.077	-0.006	0.003	0.02
<i>OBS</i>	551	0.465	0.499	0	0	1
<i>LOSS</i>	551	0.138	0.345	0	0	0
<i>Growth</i>	551	0.132	0.554	-0.013	0.064	0.181
<i>ΔNOL</i>	551	0.005	0.055	0	0	0
<i>NPPE</i>	551	0.561	0.141	0.46	0.549	0.662
<i>Intang</i>	551	0.267	0.353	0.031	0.136	0.395
<i>MI</i>	551	0	0.002	0	0	0
<i>FOREIGN</i>	551	-0.04	4.539	0	0	0.209
<i>Equity</i>	551	0.001	0.004	0	0	0
<i>DISACC</i>	551	-0.001	0.107	-0.035	0.002	0.037
<i>CashETR</i>	551	0.223	0.86	0.144	0.262	0.348

**Panel C: Firms with securitization gains, losses or securitizations as secured borrowing**

Variable	N	Mean	Std. Dev.	Lower Quartile	Median	Upper Quartile
<i>BTD</i>	746	0.007	0.052	-0.011	0.01	0.033
<i>TEMP</i>	746	0.003	0.026	-0.009	0.002	0.016
<i>PERM</i>	745	0.004	0.044	-0.005	0.004	0.019
<i>OBS</i>	746	0.327	0.469	0	0	1
<i>LOSS</i>	746	0.143	0.351	0	0	0
<i>Growth</i>	746	0.129	0.458	-0.013	0.061	0.181
$\Delta$ <i>NOL</i>	746	0.005	0.038	0	0	0
<i>NPPE</i>	743	0.557	0.139	0.459	0.548	0.659
<i>Intang</i>	746	0.283	0.356	0.031	0.156	0.413
<i>MI</i>	746	0.001	0.004	0	0	0
<i>FOREIGN</i>	746	0.176	1.815	0	0	0.256
<i>Equity</i>	746	0	0.004	0	0	0
<i>DISACC</i>	746	-0.008	0.094	-0.039	0	0.031
<i>CashETR</i>	746	0.253	0.165	0.143	0.255	0.348

**Panel D: Lease firm sample**

Variable	N	Mean	Std. Dev.	Lower Quartile	Median	Upper Quartile
<i>BTD</i>	700	0.002	0.128	-0.027	0.014	0.049
<i>TEMP</i>	730	0	0.06	-0.006	0	0.016
<i>PERM</i>	700	0.002	0.125	-0.014	0.007	0.036
<i>OBS</i>	730	0.503	0.5	0	1	1
<i>LOSS</i>	730	0.2	0.4	0	0	0
<i>Growth</i>	730	0.11	0.429	-0.048	0.06	0.22
$\Delta$ <i>NOL</i>	730	0.018	0.085	0	0	0
<i>NPPE</i>	723	0.564	0.156	0.457	0.557	0.663
<i>Intang</i>	730	0.194	0.226	0	0.113	0.313
<i>MI</i>	730	0	0.003	0	0	0
<i>FOREIGN</i>	730	-1.024	25.32	0	0	0.113
<i>Equity</i>	730	0	0.009	0	0	0
<i>DISACC</i>	726	0	0.112	-0.036	0.017	0.057
<i>CashETR</i>	730	0.249	0.178	0.118	0.255	0.35

This table presents summary statistics for variables related to the research question.

*BTD* is the total book-tax difference, which equals book income less estimated taxable income scaled by average book assets (item 6). Book income is pretax income (item 170). Estimated taxable income is calculated by summing the current federal tax expense (item 63) and current foreign tax expense (item 64) and dividing by the 35% statutory tax rate (STR) and then subtracting the change in NOL carryforwards (item 52). If current the federal tax expense is missing, the total current tax expense is calculated by subtracting deferred taxes (item 50), state income taxes (item 173), and other income taxes (item 211) from the total income taxes (item 16). *TEMP* is temporary book-tax difference, which is the sum of U.S (item 269) and foreign (item 270) deferred tax divided by the 35% statutory rate and then scaled by lagged total assets (item 6). *PERM* is permanent book-tax difference which equals *BTD* less *BTD*. *Secu\_Gain* is the value of securitization gains scaled by lagged assets. *OBS* is an indicator variable which equals one if a firm reports a securitization gain (or synthetic lease) for a year, and zero otherwise. *Loss* is an indicator variable which equals one if a firm reports negative pretax income and zero otherwise (item 170 - item 17).

*Growth* is the change in net sales (item 12) scaled by lagged assets. *ΔNOL* is the change in net operating loss carryforwards (item 52) scaled by lagged assets. *NPPE* is the ratio of net property, plant and equipment (item 8) to gross property, plant and equipment (item 7). *Intang* is sum of goodwill (item 204) and other intangibles (item 33) scaled by lagged assets. *MI* is income or loss attributable to minority interests (item 49) scaled by lagged assets. *Foreign* is the amount of foreign pretax earnings (item 273) scaled by total pretax earnings (item 170). *Equity* is income or loss attributable to the equity method (item 55) scaled by lagged assets. *DISACC* is discretionary accruals measured as the residual from the modified Jones model. *CashETR* is the five-year effective cash tax rate, which equals sum of cash taxes paid (item 317) over the previous 5 years divided by the sum of pretax income (item 170 - item 17) over the previous 5 years (or 3 years if 5 years of data are unavailable).



TABLE 3

Pearson Correlations for Research Question

Panel A: Firms with only securitization gains

	<i>BTD</i>	<i>TEMP</i>	<i>PERM</i>	<i>Secu_Gain</i>	<i>LOSS</i>	<i>Growth</i>	<i>NOL</i>	<i>NPPE</i>	<i>Intang</i>	<i>MI</i>	<i>FOREIGN</i>	<i>Equity</i>	<i>DISACC</i>
<i>BTD</i>	1												
<i>TEMP</i>	0.23*	1											
<i>PERM</i>	0.91*	-0.18*	1										
<i>Secu_Gain</i>	0.08*	-0.04	0.09	1									
<i>LOSS</i>	-0.13*	-0.13*	-0.08	0.21*	1								
<i>Growth</i>	0.18*	0.04	0.17*	0.02	-0.12	1							
<i>NOL</i>	0.68*	-0.1	0.73*	0.06	0.14*	0.1*	1						
<i>NPPE</i>	-0.02	0.06	-0.05	-0.13*	-0.04*	0.17*	-0.01	1					
<i>Intang</i>	0.04	0.04	0.03	0.14*	0	-0.03	0.01	0.04	1				
<i>MI</i>	-0.03	0.11*	-0.07	-0.02	0.09	-0.05	-0.02	0.02	0.05	1			
<i>FOREIGN</i>	0.37	-0.11*	0.42*	0.01	0	0.02	0.35*	-0.15*	-0.06	-0.08	1		
<i>Equity</i>	-0.14*	0.01	-0.14*	0.01	-0.17*	0	-0.17*	-0.04	-0.01	0	-0.02	1	
<i>DISACC</i>	0.15*	0.01	0.14*	0.03	-0.1*	-0.09	-0.14*	0.03	-0.18*	-0.01	0.03	0	1
<i>CashETR</i>	-0.12*	0.01	0.15*	0.05	0	0.05	0.1*	-0.12*	-0.02	-0.13*	0.18*	0.07	0.02

\* Indicate statistical significance at the 0.1 level.

**Panel B: Firms with securitization gains or losses**

	<i>BTD</i>	<i>TEMP</i>	<i>PERM</i>	<i>OBS</i>	<i>LOSS</i>	<i>Growth</i>	<i>NOL</i>	<i>NPPE</i>	<i>Intang</i>	<i>MI</i>	<i>FOREIGN</i>	<i>Equity</i>	<i>DISACC</i>
<i>BTD</i>	1												
<i>TEMP</i>	0.31*	1											
<i>PERM</i>	0.92*	-0.08*	1										
<i>OBS</i>	0.11*	0.04	0.09*	1									
<i>LOSS</i>	-0.27*	-0.11*	-0.22*	-0.07	1								
<i>Growth</i>	0.11*	0.08*	0.08*	0.05	-0.10*	1							
<i>NOL</i>	0.46*	-0.06	0.51*	-0.01	0.09*	0.07*	1						
<i>NPPE</i>	0.01	0.06	-0.01	0.05	0.05	0.11*	-0.02	1					
<i>Intang</i>	-0.01	0.05	-0.03	-0.20*	-0.02	0.15*	0.04	-0.02	1				
<i>MI</i>	0.01	0.02	0.02	-0.01	0.00	0.01	-0.03	0.04	0.01	1			
<i>FOREIGN</i>	0.23*	-0.06	0.26*	-0.06	-0.00	0.01	0.29*	-0.11*	-0.01	-0.03	1		
<i>Equity</i>	0.01	0.08	-0.02	-0.07	-0.14*	-0.02	-0.09*	-0.05	0.05	-0.03	0.00	1	
<i>DISACC</i>	0.34*	0.11*	0.31*	0.09*	-0.21*	0.00	-0.09*	0.01	-0.15*	0.00	0.01	0.03	1
<i>CashETR</i>	0.03	-0.03*	0.04	-0.09*	0.02	0.03	0.04	-0.06	0.07	-0.06	0.13*	0.03	-0.02

\* Indicate statistical significance at the 0.1 level.

**Panel C: Firms with securitization gains, losses or securitizations as secured borrowing**

	<i>BTD</i>	<i>TEMP</i>	<i>PERM</i>	<i>OBS</i>	<i>LOSS</i>	<i>Growth</i>	<i>NOL</i>	<i>NPPE</i>	<i>Intang</i>	<i>MI</i>	<i>FOREIGN</i>	<i>Equity</i>	<i>DISACC</i>
<i>BTD</i>	1												
<i>TEMP</i>	0.53*	1											
<i>PERM</i>	0.87*	0.04	1										
<i>OBS</i>	0.08*	0.08*	0.04	1									
<i>LOSS</i>	-0.29*	-0.28*	-0.18*	-0.11*	1								
<i>Growth</i>	0.07*	0.05	0.05	0.02	-0.14*	1							
<i>NOL</i>	0.29*	-0.08*	0.39*	-0.05	0.18*	0.05	1						
<i>NPPE</i>	-0.03	0.01	-0.03	0.07*	0.07*	0.1*	0.04	1					
<i>Intang</i>	0.12*	0.13*	0.06*	-0.13*	-0.09*	0.17*	0.05	-0.02	1				
<i>MI</i>	0.09*	0.01	0.1*	-0.04	-0.05	0.02	-0.01	0.04	-0.01	1			
<i>FOREIGN</i>	0.01	0.03	-0.01	-0.03	-0.06	0.01	-0.02	-0.05	0.03	0.00	1		
<i>Equity</i>	0.11*	0.14*	0.04	-0.08*	-0.12*	0.02	-0.05	-0.01	0.03	-0.03	0.04	1	
<i>DISACC</i>	0.26*	0.16*	0.21*	0.07*	-0.22*	0.04	-0.11*	-0.03	-0.11*	0.01	-0.03	0.05	1
<i>CashETR</i>	-0.06	-0.16*	0.02	-0.11*	0.03	0.01	0.06*	-0.08*	-0.06*	-0.06	0.05	-0.01	-0.01

\* Indicate statistical significance at the 0.1 level.

**Panel D: Lease firm sample**

	<i>BTD</i>	<i>TEMP</i>	<i>PERM</i>	<i>OBS</i>	<i>LOSS</i>	<i>Growth</i>	<i>NOL</i>	<i>NPPE</i>	<i>Intang</i>	<i>MI</i>	<i>FOREIGN</i>	<i>Equity</i>	<i>DISACC</i>
<i>BTD</i>	1												
<i>TEMP</i>	0.29*	1											
<i>PERM</i>	0.88*	-0.19*	1										
<i>OBS</i>	0.04*	0.02*	-0.05	1									
<i>LOSS</i>	-0.37*	-0.02*	-0.37*	-0.01	1								
<i>Growth</i>	0.05	-0.11*	0.11*	0.00	-0.22*	1							
<i>NOL</i>	0.36*	-0.04*	0.39*	-0.04	0.24*	0.01	1						
<i>NPPE</i>	0.04*	-0.02	0.06*	0.00	-0.04*	0.16*	0.07	1					
<i>Intang</i>	0.04	0.05	0.01	0.03	-0.08*	0.08*	0.01*	0.06	1				
<i>MI</i>	-0.01	-0.09*	0.04*	-0.01	-0.06*	0.04	-0.01	0.08*	0.02	1			
<i>FOREIGN</i>	0.01	-0.01	0.01	-0.02	0.02	0.04	0.01	0.02	0.03	-0.05	1		
<i>Equity</i>	0.06*	-0.01	0.07*	0.04	-0.18*	0.02	-0.08*	-0.06	-0.01	0.06	0.05	1	
<i>DISACC</i>	0.61*	0.23*	0.51*	-0.03	-0.33*	-0.02	-0.02*	0.00	-0.03	-0.01	0.04	0.02	1
<i>CashETR</i>	-0.03*	-0.01	-0.03*	-0.05	0.15*	-0.06*	-0.01	-0.18*	-0.01	-0.06*	0.01	0.05	0.06

\* Indicate statistical significance at the 0.1 level.

This table presents Pearson correlation coefficients among dependent and independent variables. *BTD* is the total book-tax difference, which equals book income less estimated taxable income scaled by average book assets (item 6). Book income is pretax income (item 170). Estimated taxable income is calculated by summing the current federal tax expense (item 63) and current foreign tax expense (item 64) and dividing by the 35% statutory tax rate (STR) and then subtracting the change in NOL carryforwards (item 52). If current the federal tax expense is missing, the total current tax expense is calculated by subtracting deferred taxes (item 50), state income taxes (item 173), and other income taxes (item 211) from the total income taxes (item 16). *TEMP* is temporary book-tax difference, which is the sum of U.S (item 269) and foreign (item 270) deferred tax divided by the 35% statutory rate and then scaled by lagged total assets (item 6). *PERM* is permanent book-tax difference which equals *BTD* less *TEMP*. *Secu\_Gain* is the value of securitization gains scaled by lagged assets. *OBS* is an indicator variable which equals one if a firm reports a securitization gain (or synthetic lease) for a year, and zero otherwise. *Loss* is an indicator variable which equals one if a firm reports negative pretax income and zero otherwise (item 170 - item 17). *Growth* is the change in net sales (item 12) scaled by lagged assets. *ΔNOL* is the change in net operating loss carryforwards (item 52) scaled by lagged assets. *NPPE* is the ratio of net property, plant and equipment (item8) to gross property, plant and equipment (item 7). *Intang* is sum of goodwill (item 204) and other intangibles (item 33) scaled by lagged assets. *MI* is income or loss attributable to minority interests (item 49) scaled by lagged assets. *Foreign* is the amount of foreign pretax earnings (item 273) scaled by total pretax earnings (item 170). *Equity* is income or loss attributable to the equity method (item 55) scaled by lagged assets. *DISACC* is discretionary accruals measured as the residual from the modified Jones model. *CashETR* is the five-year effective cash tax rate, which equals sum of cash taxes paid (item 317) over the previous 5 years divided by the sum of pretax income (item 170 - item 17) over the previous 5 years (or 3 years if 5 years of data are unavailable).

TABLE 4

Regression Analysis of the Effect of Off-Balance-Sheet Financing on Book-Tax Differences

Panel A: The Effect of Off-Balance-Sheet Financing on Total Book-Tax Differences

(Dependent variable = *BTD*)

Variable	(1) <i>Gain Firms Only</i>	(2) <i>Gain Firms vs. Loss Firms</i>	(3) <i>Gain Firms vs. Loss or Secured Borrowing Firms</i>	(4) <i>Lease</i>
<i>Secu_Gain</i>	0.018** (0.008)			
<i>OBS</i>		0.010** (0.005)	0.006** (0.003)	0.392*** (0.056)
<i>CashETR</i>	0.005 (0.003)	0.002 (0.002)	-0.019* (0.010)	-0.013 (0.020)
<i>DISACC</i>	0.188*** (0.043)	0.233*** (0.058)	0.126*** (0.032)	0.547*** (0.078)
<i>Growth</i>	0.018 (0.011)	0.003 (0.007)	-0.003 (0.004)	-0.046** (0.023)
$\Delta$ <i>NOL</i>	-0.048*** (0.011)	-0.046*** (0.011)	-0.039*** (0.007)	-0.087*** (0.012)
<i>LOSS</i>	0.843*** (0.111)	0.698*** (0.160)	0.530*** (0.156)	0.718*** (0.057)
<i>FOREIGN</i>	0.001** (0.000)	0.002** (0.001)	0.000 (0.001)	-0.000 (0.000)
<i>NPPE</i>	-0.021 (0.023)	0.010 (0.025)	-0.016 (0.013)	-0.017 (0.026)
<i>Intang</i>	0.021*** (0.007)	0.006 (0.009)	0.018*** (0.005)	0.017 (0.015)
<i>Equity</i>	-0.354 (1.322)	0.561 (0.951)	1.115** (0.487)	0.216 (0.257)
<i>MI</i>	2.439*** (0.789)	1.020 (0.789)	0.923*** (0.284)	-0.926 (0.989)
<i>LAGBTD</i>	0.084 (0.054)	0.180*** (0.063)	0.105*** (0.033)	0.041 (0.026)
<i>Intercept</i>	0.017 (0.021)	-0.007 (0.017)	0.022* (0.012)	-0.358*** (0.055)
Observations	276	541	698	578
Adj. R-squared	0.693	0.456	0.301	0.608

Robust standard errors are in parentheses. \*, \*\*, \*\*\* Indicate statistical significance at the 0.1, 0.05, and 0.01 levels, respectively.

**Panel B: The Effect of Off-Balance-Sheet Financing on Temporary Book-Tax Differences**

(Dependent variable = *TEMP*)

Variable	(1) <i>Gain Firms Only</i>	(2) <i>Gain Firms vs. Loss Firms</i>	(3) <i>Gain Firms vs. Loss or Secured Borrowing Firms</i>	(4) <i>Lease</i>
<i>Secu_Gain</i>	0.002 (0.007)			
<i>OBS</i>		0.002 (0.002)	0.003 (0.002)	0.064*** (0.017)
<i>CashETR</i>	0.002 (0.002)	-0.002 (0.004)	-0.019*** (0.006)	-0.015* (0.008)
<i>DISACC</i>	0.009 (0.019)	0.039** (0.016)	0.030*** (0.011)	0.085*** (0.023)
<i>Growth</i>	0.001 (0.004)	0.009** (0.004)	-0.001 (0.003)	-0.016** (0.006)
$\Delta NOL$	-0.006 (0.029)	-0.004 (0.004)	-0.016*** (0.003)	0.003 (0.005)
<i>LOSS</i>	-0.012 (0.011)	-0.099*** (0.038)	-0.011 (0.021)	-0.000 (0.027)
<i>FOREIGN</i>	-0.001*** (0.000)	0.001 (0.000)	0.000 (0.000)	0.002 (0.003)
<i>NPPE</i>	0.002 (0.013)	0.002 (0.010)	-0.001 (0.007)	0.009 (0.011)
<i>Intang</i>	0.009 (0.007)	0.013*** (0.004)	0.011*** (0.003)	-0.000 (0.007)
<i>Equity</i>	-0.133 (0.750)	-0.515 (0.676)	0.706** (0.290)	0.548 (0.409)
<i>MI</i>	2.203* (1.223)	-0.780 (0.491)	-0.092 (0.188)	-0.384 (0.913)
<i>LAGTEMP</i>	0.178*** (0.060)	0.183*** (0.051)	0.183*** (0.042)	0.166*** (0.046)
<i>Intercept</i>	0.019 (0.016)	0.003 (0.008)	0.009 (0.007)	-0.045** (0.018)
Observations	276	463	698	599
Adj. R-squared	0.027	0.100	0.165	0.095

Robust standard errors are in parentheses. \*, \*\*, \*\*\* Indicate statistical significance at the 0.1, 0.05, and 0.01 levels, respectively.

**Panel C: The Effect of Off-Balance-Sheet Financing on Permanent Book-Tax Differences**

(Dependent variable = *PERM*)

Variable	(1) <i>Gain Firms Only</i>	(2) <i>Gain Firms vs. Loss Firms</i>	(3) <i>Gain Firms vs. Loss or Secured Borrowing Firms</i>	(4) <i>Lease</i>
<i>Secu_Gain</i>	0.016* (0.008)			
<i>OBS</i>		-0.000 (0.003)	0.003 (0.003)	0.310*** (0.064)
<i>CashETR</i>	0.003 (0.003)	-0.005 (0.008)	0.002 (0.009)	-0.006 (0.021)
<i>DISACC</i>	0.175*** (0.042)	0.106*** (0.033)	0.094*** (0.027)	0.440*** (0.088)
<i>Growth</i>	0.015 (0.012)	0.008 (0.005)	-0.002 (0.004)	-0.024 (0.019)
$\Delta$ <i>NOL</i>	0.837*** (0.108)	-0.015* (0.008)	-0.023*** (0.006)	-0.095*** (0.013)
<i>LOSS</i>	-0.033** (0.014)	0.779*** (0.104)	0.540*** (0.155)	0.743*** (0.069)
<i>FOREIGN</i>	0.002*** (0.000)	-0.001* (0.000)	-0.000 (0.000)	-0.000** (0.000)
<i>NPPE</i>	-0.020 (0.019)	-0.007 (0.010)	-0.014 (0.012)	-0.008 (0.029)
<i>Intang</i>	0.011* (0.006)	-0.000 (0.005)	0.007 (0.005)	0.008 (0.016)
<i>Equity</i>	-0.118 (0.848)	0.250 (0.805)	0.391 (0.404)	0.280 (0.274)
<i>MI</i>	0.395 (1.080)	1.589* (0.947)	0.994*** (0.186)	0.952 (1.349)
<i>LAGPERM</i>	0.143** (0.064)	0.108** (0.046)	0.098** (0.038)	0.043 (0.029)
<i>Intercept</i>	-0.001 (0.011)	0.006 (0.010)	0.012 (0.009)	-0.274*** (0.061)
Observations	276	453	697	578
Adj. R-squared	0.743	0.408	0.282	0.552

Robust standard errors are in parentheses. \*, \*\*, \*\*\* Indicate statistical significance at the 0.1, 0.05, and 0.01 levels, respectively.

This table presents the result of OLS regression of the effect of off-balance-sheet financing on book-tax differences. Column (1) contains firm-years with only securitization gains. Column (2) consists of firm-years in which securitization gains or losses are reported. Column (3) includes any firm-year with securitization, either accounted for as sales accounting (with gains or losses) or as secured borrowing. Column (4) consists of firm-years with at least one synthetic lease and a matched control group which does not have synthetic leases or securitizations. The matching is implemented based on industry (two-digit SIC), year, and firm size.

In panel A, the dependent variable, *BTD*, is the total book-tax difference, which equals book income less estimated taxable income scaled by average book assets (COMPUSTAT item 6). Book income is pretax income (item 170). Estimated taxable income is calculated by summing the current federal tax expense (item 63) and current foreign tax expense (item 64) and dividing by the 35% statutory tax rate (STR) and then subtracting the change in NOL

carryforwards (item 52). If current the federal tax expense is missing, the total current tax expense is calculated by subtracting deferred taxes (item 50), state income taxes (item 173), and other income taxes (item 211) from the total income taxes (item 16). In panel B, the dependent variable, *TEMP*, is temporary book-tax difference, which is the sum of U.S (item 269) and foreign (item 270) deferred tax divided by the 35% statutory rate and then scaled by lagged total assets (item 6). In panel C, the dependent variable, *PERM*, is permanent book-tax difference which equals *BTD* less *TEMP*. *LAGBTD*, *LAGTEMP*, and *LAGPERM* are the lagged *BTD*, *TEMP*, and *PERM*, respectively. *Secu\_Gain* is the value of securitization gains scaled by lagged assets. *OBS* is an indicator variable which equals one if a firm reports a securitization gain (or synthetic lease) for a year, and zero otherwise. *CashETR* is the five-year effective cash tax rate, which equals sum of cash taxes paid (item 317) over the previous 5 years divided by the sum of pretax income (item 170 - item 17) over the previous 5 years (or 3 years if 5 years of data are unavailable). *DISACC* is discretionary accruals measured as the residual from the modified Jones model. *Growth* is the change in net sales (item 12) scaled by lagged assets. *ΔNOL* is the change in net operating loss carryforwards (item 52) scaled by lagged assets. *Loss* is an indicator variable which equals one if a firm reports negative pretax income and zero otherwise (item 170 - item 17). *Foreign* is the amount of foreign pretax earnings (item 273) scaled by total pretax earnings (item 170). *NPPE* is the ratio of net property, plant and equipment (item8) to gross property, plant and equipment (item 7). *Intang* is sum of goodwill (item 204) and other intangibles (item 33) scaled by lagged assets. *Equity* is income or loss attributable to the equity method (item 55) scaled by lagged assets. *MI* is income or loss attributable to minority interests (item 49) scaled by lagged assets. For each regression, I control for year and industry effects and winsorize all continuous variables at 1 percent and 99 percent.

TABLE 5

Descriptive Statistics for H1

Panel A: Securitization firms with positive total book-tax differences - matched sample (n=319)

Variable	Mean	Std. Dev.	Lower Quartile	Median	Upper Quartile
<i>Lead_PTBI</i>	0.081	0.077	0.032	0.075	0.113
<i>PTBI</i>	0.093	0.07	0.046	0.08	0.117
<i>OBS</i>	0.489	0.501	0	0	1
<i>DISACC</i>	0.01	0.088	-0.024	0.008	0.039
<i>CashETR</i>	0.239	0.156	0.141	0.25	0.318
<i>Assets</i>	10,076	25,082	1,304	2,852	10,905

Panel B: Securitization firms with positive temporary book-tax differences - matched sample (n=224)

Variable	Mean	Std. Dev.	Lower Quartile	Median	Upper Quartile
<i>Lead_PTBI</i>	0.073	0.081	0.024	0.067	0.107
<i>PTBI</i>	0.083	0.078	0.036	0.075	0.113
<i>OBS</i>	0.481	0.5	0	0	1
<i>DISACC</i>	0.004	0.089	-0.025	0.005	0.039
<i>CashETR</i>	0.229	0.153	0.121	0.25	0.318
<i>Assets</i>	11,647	29,415	1,614	3,113	11,885

Panel C: Securitization firms with positive permanent book-tax differences - matched sample (n=336)

Variable	Mean	Std. Dev.	Lower Quartile	Median	Upper Quartile
<i>Lead_PTBI</i>	0.074	0.088	0.023	0.07	0.117
<i>PTBI</i>	0.084	0.082	0.032	0.076	0.122
<i>OBS</i>	0.48	0.5	0	0	1
<i>DISACC</i>	0.006	0.09	-0.026	0.008	0.041
<i>CashETR</i>	0.245	0.163	0.127	0.254	0.33
<i>Assets</i>	11,030	31,655	1,131	2,585	10,526



**Panel D: Securitization firms with positive total book-tax differences - S&P sample (n=2,743)**

Variable	Mean	Std. Dev.	Lower Quartile	Median	Upper Quartile
<i>Lead_PTBI</i>	0.132	0.104	0.067	0.123	0.187
<i>PTBI</i>	0.13	0.082	0.072	0.12	0.175
<i>OBS</i>	0.026	0.158	0	0	0
<i>DISACC</i>	0.013	0.048	-0.011	0.013	0.038
<i>CashETR</i>	0.265	0.125	0.19	0.269	0.337
<i>Assets</i>	11,549	19,857	2,492	5,134	13,065

**Panel E: Securitization firms with positive temporary book-tax differences - S&P sample (n=1,873)**

Variable	Mean	Std. Dev.	Lower Quartile	Median	Upper Quartile
<i>Lead_PTBI</i>	0.096	0.096	0.038	0.096	0.157
<i>PTBI</i>	0.114	0.094	0.062	0.11	0.164
<i>OBS</i>	0.068	0.252	0	0	0
<i>DISACC</i>	0.013	0.063	-0.013	0.016	0.046
<i>CashETR</i>	0.252	0.124	0.18	0.265	0.328
<i>Assets</i>	11,736	20,501	2,469	5,157	12,961

**Panel F: Securitization firms with positive permanent book-tax differences - S&P sample (n=2826)**

Variable	Mean	Std. Dev.	Lower Quartile	Median	Upper Quartile
<i>Lead_PTBI</i>	0.133	0.104	0.067	0.123	0.188
<i>PTBI</i>	0.131	0.083	0.073	0.12	0.176
<i>OBS</i>	0.024	0.153	0	0	0
<i>DISACC</i>	0.013	0.049	-0.012	0.013	0.038
<i>CashETR</i>	0.267	0.125	0.192	0.27	0.339
<i>Assets</i>	11,603	20,869	2,475	5,008	12,947

**Panel G: Lease firms with positive total book-tax differences - matched sample (n=365)**

Variable	Mean	Std. Dev.	Lower Quartile	Median	Upper Quartile
<i>Lead_PTBI</i>	0.071	0.134	0.01	0.071	0.148
<i>PTBI</i>	0.104	0.106	0.038	0.087	0.163
<i>OBS</i>	0.515	0.5	0	1	1
<i>DISACC</i>	0.019	0.077	-0.023	0.015	0.061
<i>CashETR</i>	0.236	0.154	0.128	0.248	0.324
<i>Assets</i>	4,256	10,365	445	1,093	3,317

**Panel H: Lease firms with positive temporary book-tax differences - matched sample (n=227)**

Variable	Mean	Std. Dev.	Lower Quartile	Median	Upper Quartile
<i>Lead_PTBI</i>	0.069	0.128	0.01	0.076	0.156
<i>PTBI</i>	0.09	0.116	0.028	0.085	0.164
<i>OBS</i>	0.639	0.481	0	1	1
<i>DISACC</i>	0.009	0.075	-0.036	0.012	0.049
<i>CashETR</i>	0.239	0.152	0.136	0.242	0.325
<i>Assets</i>	4,650	11,572	517	1,162	3,317

**Panel I: Lease firms with positive permanent book-tax differences - matched sample (n=382)**

Variable	Mean	Std. Dev.	Lower Quartile	Median	Upper Quartile
<i>Lead_PTBI</i>	0.069	0.13	0.001	0.064	0.143
<i>PTBI</i>	0.091	0.122	0.02	0.08	0.16
<i>OBS</i>	0.493	0.501	0	0	1
<i>DISACC</i>	0.018	0.077	-0.025	0.017	0.06
<i>CashETR</i>	0.251	0.167	0.14	0.255	0.329
<i>Assets</i>	4,567	11,989	469	1,162	3,299

**Panel J: Lease firms with positive total book-tax differences - S&P sample (n=1,111)**

Variable	Mean	Std. Dev.	Lower Quartile	Median	Upper Quartile
<i>Lead_PTBI</i>	0.112	0.101	0.046	0.106	0.171
<i>PTBI</i>	0.135	0.097	0.071	0.123	0.183
<i>OBS</i>	0.061	0.24	0	0	0
<i>DISACC</i>	0.02	0.06	-0.011	0.02	0.049
<i>CashETR</i>	0.253	0.119	0.184	0.265	0.33
<i>Assets</i>	11,063	25,487	1,881	4,383	10,905

**Panel K: Lease firms with positive temporary book-tax differences - S&P sample (n=957)**

Variable	Mean	Std. Dev.	Lower Quartile	Median	Upper Quartile
<i>Lead_PTBI</i>	0.096	0.096	0.038	0.096	0.157
<i>PTBI</i>	0.114	0.094	0.062	0.11	0.164
<i>OBS</i>	0.068	0.252	0	0	0
<i>DISACC</i>	0.013	0.063	-0.013	0.016	0.046
<i>CashETR</i>	0.252	0.124	0.18	0.265	0.328
<i>Assets</i>	12,242	27,386	2,086	4,898	12,660

**Panel L: Lease firms with positive permanent book-tax differences  
- S&P sample (n=1,155)**

Variable	Mean	Std. Dev.	Lower Quartile	Median	Upper Quartile
<i>Lead_PTBI</i>	0.117	0.105	0.049	0.111	0.175
<i>PTBI</i>	0.138	0.105	0.072	0.126	0.189
<i>OBS</i>	0.058	0.234	0	0	0
<i>DISACC</i>	0.019	0.064	-0.012	0.019	0.049
<i>CashETR</i>	0.258	0.115	0.19	0.271	0.337
<i>Assets</i>	10,604	26,507	1,703	4,024	10,376

**Panel M: Combined firms with positive total book-tax differences - matched sample (n=694)**

Variable	Mean	Std. Dev.	Lower Quartile	Median	Upper Quartile
<i>Lead_PTBI</i>	0.075	0.125	0.025	0.075	0.136
<i>PTBI</i>	0.099	0.092	0.04	0.085	0.146
<i>OBS</i>	0.501	0.5	0	1	1
<i>DISACC</i>	0.016	0.08	-0.02	0.015	0.055
<i>CashETR</i>	0.238	0.158	0.128	0.248	0.32
<i>Assets</i>	7,726	19,658	728	1,965	7,199

**Panel N: Combined firms with positive temporary book-tax differences - matched sample (n=433)**

Variable	Mean	Std. Dev.	Lower Quartile	Median	Upper Quartile
<i>Lead_PTBI</i>	0.078	0.098	0.024	0.076	0.127
<i>PTBI</i>	0.091	0.094	0.037	0.083	0.141
<i>OBS</i>	0.58	0.494	0	1	1
<i>DISACC</i>	0.009	0.074	-0.022	0.011	0.047
<i>CashETR</i>	0.228	0.146	0.123	0.246	0.31
<i>Assets</i>	10,130	24,059	941	2,548	10,582

**Panel O: Combined firms with positive permanent book-tax differences  
- matched sample (n=546)**

Variable	Mean	Std. Dev.	Lower Quartile	Median	Upper Quartile
<i>Lead_PTBI</i>	0.08	0.116	0.021	0.079	0.14
<i>PTBI</i>	0.099	0.102	0.036	0.088	0.157
<i>OBS</i>	0.551	0.498	0	1	1
<i>DISACC</i>	0.012	0.078	-0.023	0.013	0.052
<i>CashETR</i>	0.243	0.158	0.14	0.251	0.321
<i>Assets</i>	9,957	27,702	864	2,299	8,530

**Panel P: Combined firms with positive total book-tax differences - S&P sample (n=2939)**

Variable	Mean	Std. Dev.	Lower Quartile	Median	Upper Quartile
<i>Lead_PTBI</i>	0.128	0.104	0.063	0.12	0.184
<i>PTBI</i>	0.131	0.085	0.071	0.119	0.176
<i>OBS</i>	0.04	0.196	0	0	0
<i>DISACC</i>	0.013	0.049	-0.012	0.011	0.036
<i>CashETR</i>	0.26	0.128	0.184	0.265	0.333
<i>Assets</i>	11,523	22,164	2,265	4,838	12,660

**Panel Q: Combined firms with positive temporary book-tax differences - S&P sample (n=1863)**

Variable	Mean	Std. Dev.	Lower Quartile	Median	Upper Quartile
<i>Lead_PTBI</i>	0.108	0.094	0.048	0.101	0.161
<i>PTBI</i>	0.111	0.084	0.06	0.103	0.157
<i>OBS</i>	0.056	0.23	0	0	0
<i>DISACC</i>	0.009	0.05	-0.015	0.008	0.033
<i>CashETR</i>	0.258	0.138	0.175	0.263	0.334
<i>Assets</i>	13,079	25,686	2,526	5,796	14,280

**Panel R: Combined firms with positive permanent book-tax differences  
- S&P sample (n=2330)**

Variable	Mean	Std. Dev.	Lower Quartile	Median	Upper Quartile
<i>Lead_PTBI</i>	0.135	0.102	0.069	0.124	0.189
<i>PTBI</i>	0.13	0.081	0.072	0.12	0.175
<i>OBS</i>	0.025	0.156	0	0	0
<i>DISACC</i>	0.013	0.046	-0.011	0.011	0.034
<i>CashETR</i>	0.265	0.128	0.189	0.267	0.338
<i>Assets</i>	11,929	22,000	2,463	5,074	13,071

This table reports summary statistics for variables related to my first hypothesis. *Lead\_PTBI* is pre-tax book income (item 170) of next year deflated by current year assets (item 6). *PTBI* is pre-tax book income (item 170) deflated by lagged assets (item 6). *OBS* is an indicator variable which equals one if a firm reports a securitization gain (or synthetic lease) for a year, and zero otherwise. *DISACC* is discretionary accruals measured as the residual from the modified Jones model. *CashETR* is the five-year effective cash tax rate, which equals sum of cash taxes paid (item 317) over the previous 5 years divided by the sum of pretax income (item 170 - item 17) over the previous 5 years (or 3 years if 5 years of data are unavailable). *Assets* is current year total assets (item 6).

**TABLE 6**

**Regressions of Future Pretax Earnings on Current Pretax Earnings**

$$Lead\_PTBI = \beta_0 + \beta_1 OBS + \beta_2 TaxAvoid + \beta_3 AEM + \beta_4 PTBI + \beta_5 PTBI * OBS + \beta_6 PTBI_t * TaxAvoid + \beta_7 PTBI * AEM + \varepsilon$$

**Panel A: Partitions Based on Securitization Sample**

Variable	(1) PBSD Matched	(2) PTEMP Matched	(3) PPERM Matched	(4) PBSD S&P	(5) PTEMP S&P	(6) PPERM S&P
<i>OBS</i>	-0.004 (0.013)	-0.007 (0.014)	0.000 (0.013)	0.001 (0.016)	-0.005 (0.016)	-0.003 (0.015)
<i>TaxAvoid</i>	0.014 (0.071)	0.050 (0.044)	-0.056* (0.030)	0.012 (0.007)	0.011 (0.008)	0.010 (0.007)
<i>AEM</i>	-0.018 (0.021)	-0.005 (0.019)	-0.022 (0.024)	0.007 (0.009)	-0.011 (0.008)	0.003 (0.008)
<i>PTBI</i>	0.771*** (0.129)	0.840*** (0.093)	0.778*** (0.111)	0.998*** (0.026)	0.895*** (0.029)	0.993*** (0.025)
<i>PTBI*OBS</i>	0.045 (0.144)	-0.062 (0.139)	-0.031 (0.128)	-0.108 (0.224)	-0.190 (0.248)	-0.077 (0.212)
<i>PTBI*TaxAvoid</i>	-0.018 (0.786)	-0.326 (0.431)	0.787** (0.376)	-0.115 (0.072)	-0.148* (0.082)	-0.130* (0.067)
<i>PTBI*AEM</i>	0.076 (0.191)	-0.098 (0.169)	0.022 (0.270)	-0.146** (0.068)	-0.041 (0.063)	-0.129** (0.066)
<i>Intercept</i>	0.011 (0.012)	0.009 (0.012)	0.013 (0.011)	0.005 (0.004)	0.018*** (0.004)	0.007** (0.003)
N	317	224	336	2,743	1,873	2,826
Adj. R-squared	0.520	0.582	0.530	0.551	0.551	0.557

Robust standard errors are in parentheses. \*, \*\*, \*\*\* Indicate statistical significance at the 0.1, 0.05, and 0.01 levels, respectively.

**Panel B: Partitions Based on Lease Sample**

Variable	(1) PBSD Matched	(2) PTEMP Matched	(3) PPERM Matched	(4) PBSD S&P	(5) PTEMP S&P	(6) PPERM S&P
<i>OBS</i>	0.020 (0.021)	0.037 (0.024)	0.021 (0.019)	0.003 (0.013)	0.011 (0.010)	-0.003 (0.014)
<i>TaxAvoid</i>	0.020 (0.028)	0.051* (0.028)	0.004 (0.027)	0.005 (0.011)	0.012 (0.010)	-0.013 (0.010)
<i>AEM</i>	-0.006 (0.037)	0.021 (0.041)	0.021 (0.032)	0.008 (0.013)	0.002 (0.011)	0.003 (0.013)
<i>PTBI</i>	0.924*** (0.102)	1.041*** (0.123)	0.885*** (0.091)	0.786*** (0.039)	0.814*** (0.040)	0.716*** (0.053)
<i>PTBI*OBS</i>	-0.188 (0.146)	-0.295* (0.163)	-0.257* (0.134)	-0.057 (0.110)	-0.152* (0.083)	-0.031 (0.134)
<i>PTBI*TaxAvoid</i>	-0.481 (0.303)	-1.287*** (0.244)	-0.265 (0.245)	-0.252*** (0.088)	-0.307*** (0.093)	-0.145* (0.086)
<i>PTBI*AEM</i>	-0.166 (0.405)	-0.376 (0.261)	-0.459 (0.361)	-0.231** (0.097)	-0.217** (0.089)	-0.198** (0.097)
<i>Intercept</i>	-0.022 (0.018)	-0.033* (0.020)	-0.010 (0.017)	0.014** (0.005)	0.009 (0.006)	0.028*** (0.007)
N	365	227	382	1,111	957	1,155
Adj. R-squared	0.374	0.493	0.356	0.46	0.472	0.441

Robust standard errors are in parentheses. \*, \*\*, \*\*\* Indicate statistical significance at the 0.1, 0.05, and 0.01 levels, respectively.

**Panel C: Partitions Based on Securitization and Lease Combined Sample**

Variable	(1) PBSD Matched	(2) PTEMP Matched	(3) PPERM Matched	(4) PBSD S&P	(5) PTEMP S&P	(6) PPERM S&P
<i>OBS</i>	-0.000 (0.012)	-0.010 (0.013)	0.000 (0.013)	0.001 (0.009)	0.001 (0.008)	0.002 (0.010)
<i>TaxAvoid</i>	0.008 (0.022)	0.029 (0.023)	-0.004 (0.025)	0.012* (0.007)	0.013* (0.007)	0.004 (0.006)
<i>AEM</i>	-0.048** (0.022)	-0.037* (0.021)	0.004 (0.029)	0.016* (0.009)	0.005 (0.008)	0.010 (0.009)
<i>PTBI</i>	0.843*** (0.075)	0.769*** (0.093)	0.793*** (0.082)	0.955*** (0.025)	0.856*** (0.031)	0.921*** (0.024)
<i>PTBI*OBS</i>	-0.100 (0.106)	-0.046 (0.124)	-0.136 (0.114)	-0.118 (0.097)	-0.193** (0.092)	-0.161 (0.128)
<i>PTBI*TaxAvoid</i>	-0.368 (0.241)	-0.821*** (0.298)	-0.189 (0.264)	-0.128** (0.063)	-0.104 (0.076)	-0.114* (0.059)
<i>PTBI*AEM</i>	0.304* (0.180)	0.179 (0.188)	-0.519 (0.379)	-0.203*** (0.072)	-0.153** (0.070)	-0.196*** (0.070)
<i>Intercept</i>	0.003 (0.009)	0.017* (0.009)	0.012 (0.011)	0.007** (0.003)	0.016*** (0.004)	0.016*** (0.003)
N	694	433	546	2,939	1,863	3,085
Adj. R-squared	0.436	0.481	0.367	0.516	0.509	0.519

Robust standard errors are in parentheses. \*, \*\*, \*\*\* Indicate statistical significance at the 0.1, 0.05, and 0.01 levels, respectively.

This table presents regression analysis of the effect of off-balance-sheet financing on the relation between book-tax differences and earnings persistence. For each panel of this table, Column (1) uses the *Matched* sample based on firm-years with positive total book-tax differences; Column (2) uses the *Matched* sample based on firm-years with positive temporary book-tax differences; Column (3) uses the *Matched* sample based on firm-years with positive permanent book-tax differences; Column (4) uses the *S&P* sample based on firm-years with positive total book-tax differences; Column (5) uses the *S&P* sample based on firm-years with positive temporary book-tax differences, and Column (6) uses the *S&P* sample based on firm-years with positive permanent book-tax differences.

The dependent variable, *Lead\_PTBI*, is pre-tax book income (item 170) of next year deflated by current year assets (item 6). *OBS* is an indicator variable which equals one if a firm reports a securitization gain (or synthetic lease) for a year, and zero otherwise. *TaxAvoid* is an indicator variable which equals one for firm-year observations within the positive book-tax differences group and with CashETRs in the lowest quintile of all firm-years in the sample and not in the *OBS* subsample, and zero otherwise. *AEM* is an indicator variable which equals one for firm-year observations within the total (temporary or permanent) book-tax differences group and with modified Jones model discretionary accruals in the top quintile of all firm-years and not in the *OBS* or *TaxAvoid* subsample, and zero otherwise. *PTBI* is pre-tax book income (item 170) deflated by lagged assets (item 6). *PTBI\*OBS* is the interaction between *PTBI* and *OBS*. *PTBI\*TaxAvoid* is the interaction between *PTBI* and *TaxAvoid*. *PTBI\*AEM* is the interaction between *PTBI* and *AEM*. For each regression, I control for year and industry effects and winsorize all continuous variables at 1 percent and 99 percent.

**TABLE 7**  
**Descriptive Statistics for H2**

**Panel A: Securitization matched sample (n=367)**

Variable	Mean	Std. Dev.	Lower Quartile	Median	Upper Quartile
<i>FE</i>	-0.007	0.031	-0.018	-0.002	0.006
<i>OBS</i>	0.518	0.5	0	1	1
<i>TB</i>	0.511	0.362	0.25	0.5	0.75
<i>AEM</i>	0.095	0.294	0	0	0
<i>TaxAvoid</i>	0.046	0.21	0	0	0
<i>PYFE</i>	-0.008	0.038	-0.015	-0.002	0.006
<i>ΔFOL</i>	-0.002	0.246	-0.143	0	0.118
<i>MB</i>	1.188	1.107	0.478	0.766	1.526
<i>SIZE</i>	7.999	1.554	7.04	7.911	9.128

**Panel B: Securitization S&P sample (n=3208)**

Variable	Mean	Std. Dev.	Lower Quartile	Median	Upper Quartile
<i>FE</i>	-0.007	0.03	-0.012	-0.001	0.003
<i>OBS</i>	0.033	0.18	0	0	0
<i>TB</i>	0.501	0.355	0.25	0.5	0.75
<i>AEM</i>	0.192	0.394	0	0	0
<i>TaxAvoid</i>	0.14	0.347	0	0	0
<i>PYFE</i>	-0.007	0.027	-0.013	-0.001	0.003
<i>ΔFOL</i>	-0.011	0.186	-0.13	0	0.1
<i>MB</i>	4.133	3.747	2.054	3.059	4.723
<i>SIZE</i>	8.802	1.182	8.003	8.769	9.536

**Panel C: Lease matched sample (n=305)**

Variable	Mean	Std. Dev.	Lower Quartile	Median	Upper Quartile
<i>FE</i>	-0.014	0.089	-0.018	-0.003	0.003
<i>OBS</i>	0.59	0.493	0	1	1
<i>TB</i>	0.503	0.367	0.25	0.5	0.75
<i>AEM</i>	0.085	0.28	0	0	0
<i>TaxAvoid</i>	0.052	0.223	0	0	0
<i>PYFE</i>	-0.006	0.035	-0.006	-0.001	0.001
<i>ΔFOL</i>	0.013	0.302	-0.179	0	0.154
<i>MB</i>	3.229	5.037	1.519	2.495	4.682
<i>SIZE</i>	7.629	1.453	6.508	7.595	8.668



**Panel D: Lease S&P sample (n=1056)**

Variable	Mean	Std. Dev.	Lower Quartile	Median	Upper Quartile
<i>FE</i>	-0.008	0.019	-0.014	-0.003	0.001
<i>OBS</i>	0.026	0.158	0	0	0
<i>TB</i>	0.501	0.321	0.222	0.556	0.778
<i>AEM</i>	0.191	0.394	0	0	0
<i>TaxAvoid</i>	0.123	0.329	0	0	0
<i>PYFE</i>	-0.003	0.012	-0.004	0	0.001
$\Delta FOL$	0.013	0.202	-0.125	0	0.125
<i>MB</i>	5.614	4.865	2.731	4.044	6.785
<i>SIZE</i>	8.948	1.132	8.11	8.747	9.571

**Panel E: Combined matched sample (n=672)**

Variable	Mean	Std. Dev.	Lower Quartile	Median	Upper Quartile
<i>FE</i>	-0.011	0.064	-0.018	-0.002	0.004
<i>OBS</i>	0.551	0.498	0	1	1
<i>TB</i>	0.501	0.358	0.25	0.5	0.75
<i>AEM</i>	0.08	0.272	0	0	0
<i>TaxAvoid</i>	0.048	0.213	0	0	0
<i>PYFE</i>	-0.007	0.036	-0.01	-0.001	0.003
$\Delta FOL$	0.005	0.273	-0.167	0	0.133
<i>MB</i>	2.114	3.633	0.649	1.428	2.859
<i>SIZE</i>	7.831	1.519	6.785	7.799	8.93

**Panel F: Combined S&P sample (n=3394)**

Variable	Mean	Std. Dev.	Lower Quartile	Median	Upper Quartile
<i>FE</i>	-0.007	0.03	-0.013	-0.001	0.003
<i>OBS</i>	0.037	0.189	0	0	0
<i>TB</i>	0.501	0.354	0.25	0.5	0.75
<i>AEM</i>	0.192	0.394	0	0	0
<i>TaxAvoid</i>	0.138	0.345	0	0	0
<i>PYFE</i>	-0.006	0.027	-0.012	-0.001	0.002
$\Delta FOL$	-0.01	0.188	-0.132	0	0.1
<i>MB</i>	4.166	3.792	2.075	3.07	4.798
<i>SIZE</i>	8.785	1.179	7.981	8.744	9.519

This table presents summary statistics for variables related to H2. *FE* is a firm's actual earnings in year  $t + 1$  minus the consensus forecasted earnings deflated by stock price. *OBS* is an indicator variable which equals one if a firm reports a securitization gain (or synthetic lease) for a year, and zero otherwise. *TB* is decile rank of the ratio of net tax income to net book income scaled to vary between zero and one. Net tax income is measured as  $(TAX/STR) * (1 - STR)$ , where *STR* is the top U.S. statutory corporate tax rate and *TAX* is current tax expense. *TAX* is measured as

the sum of current federal (COMPUSTAT item 63) and foreign (item 64) income taxes, or, when either of these amounts is missing, as total income tax expense (item 16) less deferred tax expense (item 50). Net book income is earnings before extraordinary items (item 18). *TaxAvoid* is an indicator variable which equals one for firm-year observations within the positive book-tax differences group and with CashETRs in the lowest quintile of all firm-years in the sample and not in the *OBS* subsample, and zero otherwise. *AEM* is an indicator variable which equals one for firm-year observations within the total (temporary or permanent) book-tax differences group and with modified Jones model discretionary accruals in the top quintile of all firm-years and not in the *OBS* or *TaxAvoid* subsample, and zero otherwise. *PYFE* is the actual earnings minus the median individual forecasted earnings from mid-year of year  $t$ , deflated by stock price.  $\Delta FOL$  is the change in the number of analysts who make earnings forecasts for a particular firm from year  $t$  to year  $t + 1$ , divided by the number from year  $t$ . *MB* is the ratio of CAP to book value of common equity (item 216). *SIZE* is the natural log of market capitalization (CAP) measured at year end (item 199  $\times$  item 54).

**TABLE 8**

**Pearson Correlations for H2**

**Panel A: Securitization matched sample**

	<i>FE</i>	<i>OBS</i>	<i>TB</i>	<i>AEM</i>	<i>TaxAvoid</i>	<i>PYFE</i>	$\Delta$ <i>FOL</i>	<i>MB</i>
<i>FE</i>	1							
<i>OBS</i>	0.01	1						
<i>TB</i>	0.01	-0.04	1					
<i>AEM</i>	0.01	-0.34*	-0.09*	1				
<i>TaxAvoid</i>	-0.03	-0.23*	-0.06	-0.07	1			
<i>PYFE</i>	0.25*	0.04	0.09*	-0.07	-0.05	1		
$\Delta$ <i>FOL</i>	0.08	-0.03	0.04	-0.06	-0.02	0.15*	1	
<i>MB</i>	0.1*	-0.07	0.13*	-0.1*	-0.04	0.14*	0.1*	1
<i>SIZE</i>	0.11*	0.1*	-0.04	0.35*	-0.14*	0.22*	-0.02	0.15*

**Panel B: Lease matched sample**

	<i>FE</i>	<i>OBS</i>	<i>TB</i>	<i>AEM</i>	<i>TaxAvoid</i>	<i>PYFE</i>	$\Delta$ <i>FOL</i>	<i>MB</i>
<i>FE</i>	1							
<i>OBS</i>	0.01	1						
<i>TB</i>	0.03	-0.14*	1					
<i>AEM</i>	-0.08	-0.37*	0.07	1				
<i>TaxAvoid</i>	0.01	-0.28*	-0.05	-0.07*	1			
<i>PYFE</i>	0.11*	-0.05	0.06	0.03	0.04*	1		
$\Delta$ <i>FOL</i>	0.15*	0.03	0.16*	-0.03	-0.01	0	1	
<i>MB</i>	0.05	0.06	0.09	-0.13*	0.01	0.12*	-0.05	1
<i>SIZE</i>	0.17*	0.03	0.15*	0.3*	-0.02	0.08	0.09	0.21*

**Panel C: Securitization S&P sample**

	<i>FE</i>	<i>OBS</i>	<i>TB</i>	<i>AEM</i>	<i>TaxAvoid</i>	<i>PYFE</i>	$\Delta$ <i>FOL</i>	<i>MB</i>
<i>FE</i>	1							
<i>OBS</i>	0.01	1						
<i>TB</i>	0.07*	0	1					
<i>AEM</i>	0.03	-0.09*	-0.06*	1				
<i>TaxAvoid</i>	0.03	-0.08*	-0.24*	-0.2*	1			
<i>PYFE</i>	0.23*	0.03	0.09*	-0.01	0.03*	1		
$\Delta$ <i>FOL</i>	0.09*	0	0.01	-0.02	0.06*	0.05*	1	
<i>MB</i>	0.07*	-0.05*	0.05*	-0.04*	0.03*	0.08*	0.08*	1
<i>SIZE</i>	0.11*	-0.01	0.05	0.47*	-0.05*	0.18*	0.07*	0.39*

**Panel D: Lease S&P sample**

	<i>FE</i>	<i>OBS</i>	<i>TB</i>	<i>AEM</i>	<i>TaxAvoid</i>	<i>PYFE</i>	$\Delta$ <i>FOL</i>	<i>MB</i>
<i>FE</i>	1							
<i>OBS</i>	0.02	1						
<i>TB</i>	0.08*	-0.03	1					
<i>AEM</i>	-0.05	-0.08*	-0.04	1				
<i>TaxAvoid</i>	-0.08*	-0.06*	-0.29*	-0.18*	1			
<i>PYFE</i>	0.18*	-0.02	-0.04	0	0.05*	1		
$\Delta$ <i>FOL</i>	0.06*	-0.03	0.01	0.02	0.06*	0	1	
<i>MB</i>	0.06*	0.04	-0.02	0.01	0.04	0.01	0.02	1
<i>SIZE</i>	0.03*	0.04	-0.09*	-0.04	0.06*	0	-0.05	0.41*

**Panel E: Combined matched sample**

	<i>FE</i>	<i>OBS</i>	<i>TB</i>	<i>AEM</i>	<i>TaxAvoid</i>	<i>PYFE</i>	$\Delta$ <i>FOL</i>	<i>MB</i>
<i>FE</i>	1							
<i>OBS</i>	0.01	1						
<i>TB</i>	0.02	-0.1*	1					
<i>AEM</i>	-0.06	-0.33*	-0.03	1				
<i>TaxAvoid</i>	0.01	-0.25*	-0.08*	-0.07*	1			
<i>PYFE</i>	0.13*	0	0.07*	-0.03	0.01	1		
$\Delta$ <i>FOL</i>	0.12*	0	0.09*	-0.05	-0.02	0.07*	1	
<i>MB</i>	0.04	0.05	0.06	-0.05	0.02	0.11*	-0.01	1
<i>SIZE</i>	0.14*	0.06	0.06	0.32*	-0.08*	0.15*	0.03	0.12*

**Panel F: Combined S&P sample**

	<i>FE</i>	<i>OBS</i>	<i>TB</i>	<i>AEM</i>	<i>TaxAvoid</i>	<i>PYFE</i>	$\Delta$ <i>FOL</i>	<i>MB</i>
<i>FE</i>	1							
<i>OBS</i>	0.01	1						
<i>TB</i>	0.06*	-0.01	1					
<i>AEM</i>	0.03	-0.1*	-0.05*	1				
<i>TaxAvoid</i>	0.02	-0.08*	-0.24*	-0.2*	1			
<i>PYFE</i>	0.23*	0.03	0.09*	-0.02	0.03*	1		
$\Delta$ <i>FOL</i>	0.09*	0	0.01	-0.03*	0.06*	0.05*	1	
<i>MB</i>	0.07*	-0.03*	0.05*	-0.04*	0.03*	0.08*	0.08*	1
<i>SIZE</i>	0.11*	0.01	0.04*	0.46*	-0.04*	0.17*	0.06*	0.38*

This table presents Pearson correlation coefficients among variables for H2. \* Indicate statistical significance at the 0.1 level.

*FE* is a firm's actual earnings in year  $t + 1$  minus the consensus forecasted earnings deflated by stock price. *OBS* is an indicator variable which equals one if a firm reports a securitization gain (or synthetic lease) for a year, and zero otherwise. *TB* is decile rank of the ratio of net tax income to net book income scaled to vary between zero and one.

Net tax income is measured as  $(TAX/STR) * (1 - STR)$ , where STR is the top U.S. statutory corporate tax rate and TAX is current tax expense. TAX is measured as the sum of current federal (COMPUSTAT item 63) and foreign (item 64) income taxes, or, when either of these amounts is missing, as total income tax expense (item 16) less deferred tax expense (item 50). Net book income is earnings before extraordinary items (item 18). *TaxAvoid* is an indicator variable which equals one for firm-year observations within the positive book-tax differences group and with CashETRs in the lowest quintile of all firm-years in the sample and not in the *OBS* subsample, and zero otherwise. *AEM* is an indicator variable which equals one for firm-year observations within the total (temporary or permanent) book-tax differences group and with modified Jones model discretionary accruals in the top quintile of all firm-years and not in the *OBS* or *TaxAvoid* subsample, and zero otherwise. *PYFE* is the actual earnings minus the median individual forecasted earnings from mid-year of year t, deflated by stock price.  $\Delta FOL$  is the change in the number of analysts who make earnings forecasts for a particular firm from year t to year t + 1, divided by the number from year t. *MB* is the ratio of CAP to book value of common equity (item 216). *SIZE* is the natural log of market capitalization (CAP) measured at year end (item 199  $\times$  item 54).

**TABLE 9**

**Regression of Off-Balance-Sheet Financing on the Relation  
between Book-Tax Differences and Forecast Errors**

$$FE_{t+1} = \beta_0 + \beta_1 TB_t + \beta_2 AEM_t + \beta_3 TaxAvoid_t + \beta_4 OBS_t + \beta_5 TB_t * OBS_t + \beta_6 TB_t * AEM_t + \beta_7 TB_t * TaxAvoid_t + \beta_8 SIZE_t + \beta_9 MB_t + \beta_{10} \Delta FOL_{t+1} + \beta_{11} PYFE_t + \varepsilon$$

Variable	(1) Securitization Matched	(2) Securitization S&P	(3) Lease Matched	(4) Lease S&P	(5) Combined Matched	(6) Combined S&P
<i>TB</i>	0.004 (0.009)	0.007*** (0.002)	-0.002 (0.015)	0.005** (0.002)	0.001 (0.009)	0.006*** (0.002)
<i>AEM</i>	-0.002 (0.011)	0.002 (0.003)	-0.127 (0.132)	-0.002 (0.004)	-0.058 (0.049)	0.001 (0.003)
<i>TaxAvoid</i>	0.006 (0.012)	0.003 (0.002)	0.008 (0.017)	-0.003 (0.003)	0.005 (0.009)	0.002 (0.002)
<i>OBS</i>	0.005 (0.007)	0.005 (0.007)	-0.001 (0.012)	0.001 (0.006)	0.004 (0.007)	0.005 (0.006)
<i>TB*OBS</i>	-0.007 (0.011)	-0.007 (0.010)	-0.024 (0.028)	-0.002 (0.009)	-0.017 (0.015)	-0.007 (0.009)
<i>TB*AEM</i>	0.013 (0.015)	-0.003 (0.005)	0.133 (0.158)	-0.002 (0.006)	0.069 (0.062)	-0.002 (0.005)
<i>TB*TaxAvoid</i>	-0.030 (0.037)	-0.003 (0.004)	-0.046* (0.024)	-0.008 (0.008)	-0.005 (0.018)	-0.002 (0.004)
<i>SIZE</i>	0.002 (0.001)	0.001* (0.001)	0.009 (0.006)	0.000 (0.000)	0.007** (0.003)	0.001* (0.001)
<i>MB</i>	0.002 (0.001)	0.000*** (0.000)	0.000 (0.000)	0.000** (0.000)	0.000 (0.000)	0.000*** (0.000)
<i>ΔFOL</i>	0.015** (0.007)	0.011*** (0.003)	0.040* (0.022)	0.006* (0.003)	0.030** (0.012)	0.011*** (0.003)
<i>PYFE</i>	0.145* (0.085)	0.209*** (0.061)	0.259 (0.223)	0.268*** (0.078)	0.134** (0.064)	0.211*** (0.060)
<i>Intercept</i>	0.006 (0.017)	-0.017*** (0.006)	-0.097** (0.048)	-0.006 (0.005)	-0.068** (0.027)	-0.031*** (0.007)
N	335	3,152	305	1,056	640	3,338
Adj. R-squared	0.155	0.101	0.138	0.100	0.091	0.102

Robust standard errors are in parentheses. \*, \*\*, \*\*\* Indicate statistical significance at the 0.1, 0.05, and 0.01 levels, respectively.

This table presents the result of OLS regression of sources of book-tax differences on the relation between such differences and forecast errors. The dependent variable, *FE*, is a firm's actual earnings in year *t* + 1 minus the consensus forecasted earnings deflated by stock price. *TB* is decile rank of the ratio of net tax income to net book

income scaled to vary between zero and one. Net tax income is measured as  $(TAX/STR) * (1 - STR)$ , where STR is the top U.S. statutory corporate tax rate and TAX is current tax expense. TAX is measured as the sum of current federal (item 63) and foreign (item 64) income taxes, or, when either of these amounts is missing, as total income tax expense (item 16) less deferred tax expense (item 50). Net book income is earnings before extraordinary items (item 18). *TaxAvoid* is an indicator variable which equals one for firm-year observations within the positive book-tax differences group and with CashETRs in the lowest quintile of all firm-years in the sample and not in the *OBS* subsample, and zero otherwise. *AEM* is an indicator variable which equals one for firm-year observations within the total (temporary or permanent) book-tax differences group and with modified Jones model discretionary accruals in the top quintile of all firm-years and not in the *OBS* or *TaxAvoid* subsample, and zero otherwise. *OBS* is an indicator variable which equals one if a firm reports a securitization gain (or synthetic lease) for a year, and zero otherwise. *TB\*OBS*, *TB\*AEM*, and *TB\*TaxAvoid* are the interactions between *TB* and *OBS*, *TB* and *AEM*, and *TB* and *TaxAvoid*, respectively. *PYFE* is the actual earnings minus the median individual forecasted earnings from mid-year of year *t*, deflated by stock price.  $\Delta FOL$  is the change in the number of analysts who make earnings forecasts for a particular firm from year *t* to year *t + 1*, divided by the number from year *t*. *MB* is the ratio of CAP to book value of common equity (item 216). *SIZE* is the natural log of market capitalization (CAP) measured at year end (item 199  $\times$  item 54). For all regressions, I control for year and industry effects and winsorize all continuous variables at 1 percent and 99 percent.

**TABLE 10**  
**Descriptive Statistics for H3**

**Panel A: Securitization matched sample**

Variable	N	Mean	Std. Dev.	Lower Quartile	Median	Upper Quartile
<i>AUDFEE</i>	265	0.592	1.289	-0.342	0.489	1.526
<i>ABSBTD</i>	265	4.495	1.672	3.494	4.546	5.525
<i>TEMP</i>	259	3.127	1.748	2.01	3.073	4.253
<i>PERM</i>	265	4.234	1.814	3.071	4.348	5.437
<i>OBS</i>	265	0.472	0.5	0	0	1
<i>ACC</i>	265	0.042	0.2	0	0	0
<i>TaxAvoid</i>	265	0.03	0.171	0	0	0
<i>OPINION</i>	265	0.992	0.087	1	1	1
<i>FOREIGN</i>	265	-0.222	5.973	0	0	0.329
<i>ln(ASSETS)</i>	265	8.26	1.391	7.383	7.963	9.297
<i>INV</i>	265	0.184	0.157	0.066	0.143	0.274
<i>REC</i>	265	0.149	0.126	0.053	0.126	0.207
<i>LOSS</i>	265	0.208	0.406	0	0	0
<i>PROFIT</i>	265	0.089	0.067	0.049	0.079	0.111
<i>BigN</i>	265	0.966	0.181	1	1	1

**Panel B: Lease matched sample**

Variable	N	Mean	Std. Dev.	Lower Quartile	Median	Upper Quartile
<i>AUDFEE</i>	418	-0.307	1.124	-1.094	-0.351	0.412
<i>ABSBTD</i>	421	4.019	1.95	2.724	3.989	5.362
<i>TEMP</i>	370	2.778	1.842	1.662	2.857	3.858
<i>PERM</i>	421	3.945	1.939	2.646	3.899	5.241
<i>OBS</i>	421	0.508	0.501	0	1	1
<i>ACC</i>	421	0.09	0.287	0	0	0
<i>TaxAvoid</i>	421	0.067	0.249	0	0	0
<i>OPINION</i>	421	0.007	0.084	0	0	0
<i>FOREIGN</i>	421	-0.301	10.61	0	0	0.224
<i>ln(ASSETS)</i>	421	7.513	1.511	6.517	7.353	8.459
<i>INV</i>	420	0.106	0.136	0.005	0.052	0.145
<i>REC</i>	420	0.157	0.166	0.058	0.124	0.215
<i>LOSS</i>	421	0.356	0.479	0	0	1
<i>PROFIT</i>	420	0.071	0.143	0.024	0.072	0.134
<i>BigN</i>	421	0.981	0.137	1	1	1



**Panel C: Securitization S&P sample**

Variable	N	Mean	Std. Dev.	Lower Quartile	Median	Upper Quartile
<i>AUDFEE</i>	1,898	1.034	1.064	0.336	1.034	1.755
<i>ABSBTD</i>	1,898	5.162	1.582	4.205	5.172	6.269
<i>TEMP</i>	1,847	3.737	1.596	2.773	3.825	4.82
<i>PERM</i>	1,897	5.176	1.616	4.281	5.201	6.222
<i>OBS</i>	1,898	0.037	0.189	0	0	0
<i>ACC</i>	1,898	0.192	0.394	0	0	0
<i>TaxAvoid</i>	1,898	0.149	0.356	0	0	0
<i>OPINION</i>	1,898	0.002	0.046	0	0	0
<i>FOREIGN</i>	1,898	0.247	0.487	0	0.127	0.46
<i>ln(ASSETS)</i>	1,898	8.909	1.084	8.035	8.835	9.692
<i>INV</i>	1,898	0.112	0.111	0.025	0.084	0.161
<i>REC</i>	1,898	0.138	0.089	0.073	0.127	0.185
<i>LOSS</i>	1,898	0.181	0.385	0	0	0
<i>PROFIT</i>	1,898	0.126	0.084	0.07	0.117	0.175
<i>BigN</i>	1,898	0.987	0.114	1	1	1

**Panel D: Lease S&P sample**

Variable	N	Mean	Std. Dev.	Lower Quartile	Median	Upper Quartile
<i>AUDFEE</i>	737	0.333	0.953	-0.33	0.319	0.962
<i>ABSBTD</i>	737	4.888	1.502	3.816	4.89	6
<i>TEMP</i>	712	3.384	1.687	2.356	3.516	4.493
<i>PERM</i>	736	4.803	1.69	3.839	4.878	5.879
<i>OBS</i>	737	0.102	0.303	0	0	0
<i>ACC</i>	737	0.174	0.379	0	0	0
<i>TaxAvoid</i>	737	0.132	0.338	0	0	0
<i>OPINION</i>	737	0	0	0	0	0
<i>FOREIGN</i>	737	0.204	0.507	0	0.078	0.415
<i>ln(ASSETS)</i>	737	8.452	1.167	7.606	8.331	9.311
<i>INV</i>	737	0.108	0.105	0.02	0.083	0.157
<i>REC</i>	737	0.135	0.082	0.069	0.126	0.182
<i>LOSS</i>	737	0.246	0.431	0	0	0
<i>PROFIT</i>	737	0.12	0.104	0.056	0.115	0.179
<i>BigN</i>	737	0.991	0.097	1	1	1

**Panel E: Securitization and lease combined matched sample**

Variable	N	Mean	Std. Dev.	Lower Quartile	Median	Upper Quartile
<i>AUDFEE</i>	370	-0.285	1.007	-1	-0.285	0.412
<i>ABSBTD</i>	370	4.09	1.732	2.821	4.037	5.358
<i>TEMP</i>	328	2.82	1.687	1.703	2.889	3.854
<i>PERM</i>	370	3.967	1.79	2.713	3.936	5.208
<i>OBS</i>	370	0.524	0.5	0	1	1
<i>ACC</i>	370	0.089	0.285	0	0	0
<i>TaxAvoid</i>	370	0.062	0.242	0	0	0
<i>OPINION</i>	370	0.008	0.09	0	0	0
<i>FOREIGN</i>	370	0.179	0.455	0	0	0.224
<i>ln(ASSETS)</i>	370	7.549	1.363	6.556	7.412	8.477
<i>INV</i>	370	0.108	0.133	0.007	0.055	0.148
<i>REC</i>	370	0.146	0.111	0.058	0.121	0.211
<i>LOSS</i>	370	0.346	0.476	0	0	1
<i>PROFIT</i>	370	0.075	0.098	0.027	0.075	0.132
<i>BigN</i>	370	0.984	0.126	1	1	1

**Panel F: Securitization and lease combined S&P sample**

Variable	N	Mean	Std. Dev.	Lower Quartile	Median	Upper Quartile
<i>AUDFEE</i>	2,047	0.936	1.024	0.209	0.956	1.649
<i>ABSBTD</i>	2,047	5.151	1.487	4.176	5.161	6.238
<i>TEMP</i>	1,979	3.663	1.599	2.714	3.748	4.727
<i>PERM</i>	2,046	5.13	1.601	4.244	5.196	6.195
<i>OBS</i>	2,047	0.071	0.257	0	0	0
<i>ACC</i>	2,047	0.188	0.39	0	0	0
<i>TaxAvoid</i>	2,047	0.14	0.347	0	0	0
<i>OPINION</i>	2,047	0.001	0.038	0	0	0
<i>FOREIGN</i>	2,047	0.239	0.488	0	0.114	0.449
<i>ln(ASSETS)</i>	2,047	8.81	1.092	7.958	8.751	9.621
<i>INV</i>	2,047	0.11	0.109	0.023	0.082	0.16
<i>REC</i>	2,047	0.137	0.088	0.072	0.125	0.185
<i>LOSS</i>	2,047	0.201	0.401	0	0	0
<i>PROFIT</i>	2,047	0.123	0.088	0.066	0.114	0.175
<i>BigN</i>	2,047	0.988	0.108	1	1	1

This table presents summary statistics for variables related to H3. *AUDFEE* is the natural log of audit-related fees. *ABSBTD* is the natural log of the absolute value of total book-tax differences. *ABSTEMP* is the natural log of the absolute value of temporary book-tax differences. *ABSPERM* is the natural log of the absolute value of permanent book-tax differences. *OBS* is an indicator variable which equals one if a firm reports a securitization gain (or synthetic lease) for a year, and zero otherwise. *ACC* is an indicator variable which equals one for firm-years in the top quintile of total accruals scaled by lagged assets, without synthetic leases or securitizations, and not in the *TaxAvoid* subsample, and zero otherwise. *TaxAvoid* is an indicator variable which equals one for firm-years in the lowest *CashETRs* quintile in the sample, without synthetic leases or securitizations, and not in the *ACC* subsample,

and zero otherwise. *OPINION* is a dummy variable which equals 1 if an audit opinion other than an unqualified opinion is given in the current year, and 0 otherwise. *FOREIGN* is the ratio of foreign pre-tax income (item 273) to total pre-tax income (item 170).  $\ln(ASSETS)$  is the natural log of total assets (item 6). *INV* is the total value of inventory (item 3) scaled by assets (item 6). *REC* is the total value of receivables (item 2) scaled by assets (item 6). *LOSS* is a dummy variable which equals 1 if income before extraordinary items and discontinued operations (item 18 - item 66) is negative in the current or prior fiscal year, and 0 otherwise. *PROFIT* is firm profit which is measured by operating income (item 178) scaled by assets (item 6). *BigN* is a dummy variable with a value of one if the firm is audited by a Big 5 (including Arthur Anderson) accounting firm in the current fiscal year, and zero otherwise.

**TABLE 11**  
**Pearson Correlations for H3**

**Panel A: Securitization matched sample**

	<i>AUDFEE</i>	<i>ABSBTD</i>	<i>ABSTEMP</i>	<i>ABSPERM</i>	<i>OBS</i>	<i>ACC</i>	<i>TaxAvoid</i>	<i>OPINION</i>	<i>FOREIGN</i>	<i>ln(ASSETS)</i>	<i>INV</i>	<i>REC</i>	<i>LOSS</i>	<i>PROFIT</i>
<i>AUDFEE</i>	1													
<i>ABSBTD</i>	0.64*	1												
<i>ABSTEMP</i>	0.65*	0.79*	1											
<i>ABSPERM</i>	0.66*	0.83*	0.76*	1										
<i>OBS</i>	0.08	0.11*	0.05	0.07	1									
<i>ACC</i>	0.35*	0.37*	0.38*	0.34*	-0.3*	1								
<i>TaxAvoid</i>	-0.05	-0.08	-0.1*	-0.04	-0.21*	-0.07	1							
<i>OPINION</i>	0.1	0.05	0.03	0.03	-0.09	0.03	0.02	1						
<i>FOREIGN</i>	-0.01	-0.09	-0.04	-0.09	-0.09	0.03	0.02	0	1					
<i>ln(ASSETS)</i>	0.76*	0.72*	0.77*	0.69*	0.08	0.37*	-0.16*	0	0.02	1				
<i>INV</i>	-0.5*	-0.36*	-0.37*	-0.38*	-0.06	-0.17*	-0.05	-0.08	0.04	-0.43*	1			
<i>REC</i>	0.36*	0.11*	0.11*	0.15*	0.17*	0.06	-0.1	-0.01	0.01	0.33*	-0.18*	1		
<i>LOSS</i>	0.09	0.12*	0.05	0.1*	0.24*	0.1*	-0.02	-0.06	-0.15*	-0.07	-0.12*	0.04	1	
<i>PROFIT</i>	-0.3*	-0.24*	-0.19*	-0.25*	-0.2*	-0.2*	-0.04*	0.07	0.06	-0.17*	0.29**	-0.15*	-0.53*	1
<i>BigN</i>	0.05*	0.08	0.16*	0.05	0.05	0.06	0.04	-0.02	-0.02	0.12*	0.02	-0.03	-0.06	-0.02

\* Indicate statistical significance at the 0.1 level.

**Panel B: Securitization S&P sample**

	<i>AUDFEE</i>	<i>ABSBTD</i>	<i>ABSTEMP</i>	<i>ABSPERM</i>	<i>OBS</i>	<i>ACC</i>	<i>TaxAvoid</i>	<i>OPINION</i>	<i>FOREIGN</i>	<i>ln(ASSETS)</i>	<i>INV</i>	<i>REC</i>	<i>LOSS</i>	<i>PROFIT</i>
<i>AUDFEE</i>	1													
<i>ABSBTD</i>	0.48*	1												
<i>TEMP</i>	0.41*	0.64*	1											
<i>PERM</i>	0.51*	0.75*	0.57*	1										
<i>OBS</i>	0.03	-0.01	-0.01	-0.03	1									
<i>ACC</i>	0.36*	0.43*	0.45*	0.42*	-0.1*	1								
<i>TaxAvoid</i>	-0.06*	0.01	-0.04*	0.01	-0.08*	-0.2*	1							
<i>OPINION</i>	0	0	-0.01	0.01	0.11*	0.04	-0.02	1						
<i>FOREIGN</i>	0.18*	-0.04*	-0.1*	0.01	-0.02	-0.03	0.01*	-0.02	1					
<i>ln(ASSETS)</i>	0.65*	0.63*	0.64*	0.63*	-0.01	0.61*	-0.13*	0.02	-0.01	1				
<i>INV</i>	-0.19*	-0.25*	-0.21*	-0.21*	0.02	-0.18*	-0.12	0.05*	-0.02	-0.19*	1			
<i>REC</i>	0.15*	-0.1*	-0.1*	-0.06*	0.11*	-0.15*	-0.02	0.01	0.12*	-0.1*	0.13*	1		
<i>LOSS</i>	0.02	0.11*	0.07*	0.05*	0.05*	0.13*	0	0.04*	-0.19*	-0.03	-0.16*	-0.1*	1	
<i>PROFIT</i>	-0.11*	-0.06*	-0.08*	0.01	-0.1*	-0.09*	-0.02	-0.05*	0.1*	-0.09*	0.16*	0.13*	-0.47*	1
<i>BigN</i>	0.07*	0.06*	0.06*	0.05*	0.02	0.06*	-0.04*	0.01	0.02	0.11*	-0.04	-0.03	-0.01	-0.06*

\* Indicate statistical significance at the 0.1 level.

**Panel C: Lease matched sample**

	<i>AUDFEE</i>	<i>ABSBTD</i>	<i>ABSTEMP</i>	<i>ABSPERM</i>	<i>OBS</i>	<i>ACC</i>	<i>TaxAvoid</i>	<i>OPINION</i>	<i>FOREIGN</i>	<i>ln(ASSETS)</i>	<i>INV</i>	<i>REC</i>	<i>LOSS</i>	<i>PROFIT</i>
<i>AUDFEE</i>	1													
<i>ABSBTD</i>	0.61*	1												
<i>ABSTEMP</i>	0.58*	0.75*	1											
<i>ABSPERM</i>	0.61*	0.83*	0.7*	1										
<i>OBS</i>	0.03	0.07	0.13*	0.08*	1									
<i>ACC</i>	0.32*	0.26*	0.2*	0.31*	-0.32*	1								
<i>TaxAvoid</i>	-0.08*	0	-0.02	0	-0.27*	-0.08*	1							
<i>OPINION</i>	0.01	-0.05	-0.02	-0.08	-0.03	-0.03	-0.02	1						
<i>FOREIGN</i>	0.04	0.01	0.01	0.01	0.05	0.01	0.01	0	1					
<i>ln(ASSETS)</i>	0.8*	0.68*	0.68*	0.67*	0.1*	0.37*	-0.07	-0.02	0.04	1				
<i>INV</i>	-0.01	-0.09*	-0.04	-0.05	-0.06	-0.04	-0.13*	0.07	0.04	0.03	1			
<i>REC</i>	0.06	-0.11*	-0.14*	-0.15*	-0.08	-0.09*	-0.04	0.05	-0.03	-0.07	-0.05	1		
<i>LOSS</i>	-0.03	0.14*	0.12*	0.11*	0.05	-0.01	0.04	-0.06	-0.08	-0.17*	-0.16*	-0.05	1	
<i>PROFIT</i>	0.05	-0.13*	-0.11*	-0.05	-0.04	0.04	-0.05	0.06	-0.01	0.12*	0.13*	0.15*	-0.53*	1
<i>BigN</i>	0.13*	0.05	0.06	0.05	0	0.04	-0.1*	0.01	-0.01	0.11*	0.02	0.05	-0.08	0.02

\* Indicate statistical significance at the 0.1 level.

**Panel D: Lease S&P sample**

	<i>AUDFEE</i>	<i>ABSBTD</i>	<i>ABSTEMP</i>	<i>ABSPERM</i>	<i>OBS</i>	<i>ACC</i>	<i>TaxAvoid</i>	<i>FOREIGN</i>	<i>ln(ASSETS)</i>	<i>INV</i>	<i>REC</i>	<i>LOSS</i>	<i>PROFIT</i>
<i>AUDFEE</i>	1												
<i>ABSBTD</i>	0.46*	1											
<i>ABSTEMP</i>	0.41*	0.64*	1										
<i>ABSPERM</i>	0.47*	0.76*	0.57*	1									
<i>OBS</i>	0.02	0.02	0.07*	0.03	1								
<i>ACC</i>	0.39*	0.43*	0.43*	0.41*	-0.15*	1							
<i>TaxAvoid</i>	-0.18*	-0.04	-0.13*	-0.03	-0.13*	-0.18*	1						
<i>FOREIGN</i>	0.11*	-0.02	-0.05	0.04	-0.01	-0.03	-0.03*	1					
<i>ln(ASSETS)</i>	0.69*	0.63*	0.61*	0.59*	0.06	0.57*	-0.2*	0	1				
<i>INV</i>	-0.12*	-0.23*	-0.15*	-0.14*	-0.04	-0.16*	-0.11	-0.01	-0.13*	1			
<i>REC</i>	0.13*	-0.16*	-0.17*	-0.12*	-0.11*	-0.13*	0	0.09*	-0.13*	0.16*	1		
<i>LOSS</i>	0	0.15*	0.11*	0.11*	0.03	0.1*	0.12*	-0.22*	-0.12*	-0.17*	-0.17*	1	
<i>PROFIT</i>	-0.02	-0.06*	-0.03	-0.03	-0.08*	-0.06	-0.12*	0.14*	0.05	0.18*	0.23*	-0.56*	1
<i>BigN</i>	0.04	0.06*	0.05	0.04	0.03	0.05	0	0.01	0.06*	-0.08*	-0.05	0.02	-0.06

\* Indicate statistical significance at the 0.1 level.

**Panel E: Combined matched sample**

	<i>AUDFEE</i>	<i>ABSBTD</i>	<i>ABSTEMP</i>	<i>ABSPERM</i>	<i>OBS</i>	<i>ACC</i>	<i>TaxAvoid</i>	<i>OPINION</i>	<i>FOREIGN</i>	<i>ln(ASSETS)</i>	<i>INV</i>	<i>REC</i>	<i>LOSS</i>	<i>PROFIT</i>
<i>AUDFEE</i>	1													
<i>ABSBTD</i>	0.55*	1												
<i>ABSTEMP</i>	0.5*	0.7*	1											
<i>ABSPERM</i>	0.55*	0.81*	0.65*	1										
<i>OBS</i>	-0.02	0.05	0.08	0.05	1									
<i>ACC</i>	0.28*	0.21*	0.19*	0.27*	-0.33*	1								
<i>TaxAvoid</i>	-0.05	0.03	0.01	0.03	-0.27*	-0.08	1							
<i>OPINION</i>	0.02	-0.07	-0.03	-0.09*	-0.04	-0.03	-0.02	1						
<i>FOREIGN</i>	0.15*	-0.01	-0.08	0.01	-0.11*	0.04	0.09*	0	1					
<i>ln(ASSETS)</i>	0.76*	0.63*	0.61*	0.62*	0.08	0.36*	-0.06	-0.02	0.05	1				
<i>INV</i>	-0.01	-0.1*	-0.08	-0.06	-0.09*	-0.03	-0.13*	0.07	-0.03	0.03	1			
<i>REC</i>	0.06	-0.18*	-0.23*	-0.25*	-0.14*	-0.11*	-0.03	0.08	0.06	-0.16*	0.02	1		
<i>LOSS</i>	-0.04	0.13*	0.12*	0.1*	0.07	-0.05	0.03*	-0.07	-0.19*	-0.2*	-0.15*	-0.08	1	
<i>PROFIT</i>	0.03	-0.17*	-0.07	-0.11*	-0.02	0.08	-0.09*	0.1*	0.08	0.16*	0.12*	0.13*	-0.65*	1
<i>BigN</i>	0.14*	0.02	0.04	0.02	-0.04	0.04	-0.14	0.01	0.05	0.12*	0.04	0.03	-0.09*	0.1*

\* Indicate statistical significance at the 0.1 level.

**Panel F: Combined S&P sample**

	<i>AUDFEE</i>	<i>ABSBTD</i>	<i>ABSTEMP</i>	<i>ABSPERM</i>	<i>OBS</i>	<i>ACC</i>	<i>TaxAvoid</i>	<i>OPINION</i>	<i>FOREIGN</i>	<i>ln(ASSETS)</i>	<i>INV</i>	<i>REC</i>	<i>LOSS</i>	<i>PROFIT</i>
<i>AUDFEE</i>	1													
<i>ABSBTD</i>	0.45*	1												
<i>ABSTEMP</i>	0.38*	0.62*	1											
<i>ABSPERM</i>	0.48*	0.76*	0.54*	1										
<i>OBS</i>	-0.04*	-0.03	0	-0.04	1									
<i>ACC</i>	0.34*	0.41*	0.42*	0.4*	-0.13*	1								
<i>TaxAvoid</i>	-0.09*	0.01	-0.06*	0.01	-0.11*	-0.19*	1							
<i>OPINION</i>	-0.05*	-0.04*	-0.02	-0.02	0.09*	0.01	-0.02	1						
<i>FOREIGN</i>	0.18*	-0.03	-0.09*	0.02	-0.03	-0.02	0.01	-0.02	1					
<i>ln(ASSETS)</i>	0.64*	0.6*	0.62*	0.59*	-0.01	0.58*	-0.15*	0.01	-0.01	1				
<i>INV</i>	-0.16*	-0.24*	-0.17*	-0.19*	0.01	-0.17*	-0.11*	0.07*	-0.02	-0.16*	1			
<i>REC</i>	0.14*	-0.11*	-0.13*	-0.08*	0.03	-0.14*	-0.01	0.02	0.1*	-0.1*	0.12*	1		
<i>LOSS</i>	-0.04*	0.11*	0.06*	0.05*	0.05*	0.1*	0.04*	0.01	-0.2*	-0.09*	-0.13*	-0.11*	1	
<i>PROFIT</i>	-0.06*	-0.06*	-0.05*	0.01	-0.09*	-0.07*	-0.05*	-0.03	0.11*	-0.05*	0.14*	0.14*	-0.48*	1
<i>BigN</i>	0.06*	0.04*	0.05*	0.04*	0.03	0.05*	-0.03	0	0.02	0.09*	-0.04*	-0.03	0.01	-0.07*

This table presents Pearson correlation coefficients among variables for H3. \* Indicate statistical significance at the 0.1 level.

*AUDFEE* is the natural log of audit-related fees. *ABSBTD* is the natural log of the absolute value of total book-tax differences. *ABSTEMP* is the natural log of the absolute value of temporary book-tax differences. *ABSPERM* is the natural log of the absolute value of permanent book-tax differences. *OBS* is an indicator variable which equals one if a firm reports a securitization gain (or synthetic lease) for a year, and zero otherwise. *ACC* is an indicator variable which equals one for firm-years in the top quintile of total accruals scaled by lagged assets, without synthetic leases or securitizations, and not in the *TaxAvoid* subsample, and zero otherwise. *TaxAvoid* is an indicator variable which equals one for firm-years in the lowest *CashETRs* quintile in the sample, without synthetic leases or securitizations, and not in the *ACC* subsample, and zero otherwise. *OPINION* is a dummy variable which equals 1 if an audit opinion other than an unqualified opinion is given in the current year, and 0 otherwise. *FOREIGN* is the ratio of foreign pre-tax income (item 273) to total pre-tax income (item 170). *ln(ASSETS)* is the natural log of total assets (item 6). *INV* is the total value of inventory (item 3) scaled by assets (item 6). *REC* is the total value of receivables (item 2) scaled by assets (item 6). *LOSS* is a dummy variable which equals 1 if income before extraordinary items and discontinued operations (item 18 - item 66) is negative in the current or prior fiscal year, and 0 otherwise. *PROFIT* is firm profit which is measured by operating income (item 178) scaled by assets (item 6). *BigN* is a dummy variable with a value of one if the firm is audited by a Big 5 (including Arthur Anderson) accounting firm in the current fiscal year, and zero otherwise.

**TABLE 12**  
**Regression of Off-Balance-Sheet Financing on the Relation**  
**between Book-Tax Differences and Audit Fees**

**Panel A: Log of absolute value of total book-tax differences**

$$AUDFEE_t = \beta_0 + \beta_1 ABSBTD_t + \beta_2 OBS_t + \beta_3 TaxAvoid_t + \beta_4 ACC_t + \beta_5 ABSBTD_t * OBS_t + \beta_6 ABSBTD_t * TaxAvoid_t + \beta_7 ABSBTD_t * ACC_t + \beta_j \sum Controls_t + \varepsilon$$

Variable	(1) Securitization Matched	(2) Securitization S&P	(3) Lease Matched	(4) Lease S&P	(5) Combined Matched	(6) Combined S&P
<i>ABSBTD</i>	0.154*** (0.056)	0.083*** (0.014)	0.072 (0.044)	0.049 (0.031)	0.075* (0.043)	0.092*** (0.015)
<i>OBS</i>	0.407 (0.272)	-0.184 (0.316)	0.036 (0.177)	0.278 (0.209)	-0.011 (0.172)	0.330* (0.187)
<i>TaxAvoid</i>	0.995* (0.576)	0.146 (0.162)	-0.162 (0.331)	0.048 (0.216)	0.030 (0.402)	0.150 (0.155)
<i>ACC</i>	0.764 (0.729)	0.241 (0.161)	0.056 (0.321)	0.603* (0.329)	0.067 (0.324)	0.434** (0.179)
<i>ABSBTD*OBS</i>	-0.089 (0.064)	0.042 (0.057)	-0.047 (0.046)	-0.071* (0.043)	-0.034 (0.046)	-0.070* (0.036)
<i>ABSBTD*TaxAvoid</i>	-0.183 (0.121)	-0.045 (0.030)	-0.010 (0.087)	-0.048 (0.045)	-0.044 (0.100)	-0.049* (0.030)
<i>ABSBTD*ACC</i>	-0.104 (0.128)	-0.050** (0.025)	-0.033 (0.065)	-0.117** (0.055)	-0.030 (0.065)	-0.088*** (0.028)
<i>OPINION</i>	0.836*** (0.120)	-0.851*** (0.136)	0.446*** (0.139)		0.412*** (0.138)	-0.932*** (0.158)
<i>FOREIGN</i>	0.165*** (0.051)	0.311*** (0.038)	0.201*** (0.069)	0.222*** (0.062)	0.246*** (0.070)	0.309*** (0.036)
<i>ln(ASSETS)</i>	0.485*** (0.052)	0.526*** (0.021)	0.570*** (0.037)	0.591*** (0.032)	0.553*** (0.039)	0.534*** (0.019)
<i>INV</i>	-1.437*** (0.314)	-0.510*** (0.150)	-0.144 (0.266)	-0.271 (0.244)	-0.142 (0.249)	-0.441*** (0.142)
<i>REC</i>	1.647*** (0.411)	2.598*** (0.212)	1.741*** (0.270)	3.091*** (0.334)	1.794*** (0.289)	2.613*** (0.197)
<i>LOSS</i>	0.222* (0.115)	0.168*** (0.044)	0.208** (0.088)	0.301*** (0.068)	0.232** (0.090)	0.188*** (0.040)
<i>PROFIT</i>	-1.513* (0.801)	-0.969*** (0.204)	-0.687* (0.408)	-0.563* (0.290)	-0.479 (0.450)	-0.831*** (0.183)
<i>BigN</i>	-0.130 (0.216)	0.100 (0.130)	0.300 (0.255)	-0.064 (0.356)	0.290 (0.243)	0.148 (0.129)
<i>Intercept</i>	-4.718*** (0.613)	-4.773*** (0.221)	-5.314*** (0.359)	-5.106*** (0.432)	-5.377*** (0.357)	-4.046*** (0.210)
N	241	1,862	375	737	370	2,047
Adj. R-squared	0.749	0.635	0.652	0.580	0.649	0.642



**Panel B: Log of absolute value of temporary book-tax differences**

$$AUDFEE_t = \beta_0 + \beta_1 ABSTEMP_t + \beta_2 OBS_t + \beta_3 TaxAvoid_t + \beta_4 ACC_t + \beta_5 ABSTEMP_t * OBS_t + \beta_6 ABSTEMP_t * TaxAvoid_t + \beta_7 ABSTEMP_t * ACC_t + \beta_j \sum Controls_t + \varepsilon$$

Variable	(1) Securitization Matched	(2) Securitization S&P	(3) Lease Matched	(4) Lease S&P	(5) Combined Matched	(6) Combined S&P
<i>ABSTEMP</i>	0.196*** (0.069)	0.021 (0.014)	0.034 (0.048)	-0.015 (0.024)	0.071 (0.048)	0.024 (0.015)
<i>OBS</i>	0.312 (0.212)	-0.077 (0.270)	-0.037 (0.132)	0.367** (0.169)	0.007 (0.136)	0.195 (0.160)
<i>TaxAvoid</i>	0.614** (0.247)	0.092 (0.113)	-0.398** (0.194)	-0.102 (0.167)	-0.301 (0.261)	0.078 (0.106)
<i>ACC</i>	1.107*** (0.406)	0.038 (0.150)	0.153 (0.261)	0.070 (0.237)	0.237 (0.271)	0.071 (0.149)
<i>ABSTEMP*OBS</i>	-0.085 (0.073)	0.032 (0.064)	-0.036 (0.050)	-0.116*** (0.043)	-0.060 (0.051)	-0.057 (0.040)
<i>ABSTEMP*TaxAvoid</i>	-0.136 (0.092)	-0.045 (0.030)	0.082 (0.087)	-0.016 (0.049)	0.006 (0.110)	-0.044 (0.029)
<i>ABSTEMP*ACC</i>	-0.204* (0.108)	-0.019 (0.029)	-0.081 (0.076)	-0.028 (0.050)	-0.117 (0.078)	-0.032 (0.030)
<i>OPINION</i>	0.829*** (0.111)	-1.059*** (0.184)	0.415*** (0.124)		0.376*** (0.120)	-1.078*** (0.189)
<i>FOREIGN</i>	0.167*** (0.053)	0.305*** (0.038)	0.214*** (0.079)	0.207*** (0.062)	0.276*** (0.082)	0.318*** (0.037)
<i>ln(ASSETS)</i>	0.446*** (0.054)	0.568*** (0.021)	0.594*** (0.032)	0.635*** (0.030)	0.577*** (0.034)	0.569*** (0.020)
<i>INV</i>	-1.502*** (0.307)	-0.609*** (0.149)	-0.150 (0.271)	-0.435* (0.240)	-0.164 (0.259)	-0.631*** (0.141)
<i>REC</i>	1.664*** (0.422)	2.556*** (0.218)	1.707*** (0.278)	2.998*** (0.342)	1.765*** (0.304)	2.505*** (0.203)
<i>LOSS</i>	0.214* (0.115)	0.210*** (0.044)	0.171* (0.089)	0.316*** (0.068)	0.188** (0.090)	0.235*** (0.041)
<i>PROFIT</i>	-1.597** (0.793)	-0.975*** (0.208)	-0.817* (0.421)	-0.301 (0.286)	-0.565 (0.449)	-0.740*** (0.187)
<i>BigN</i>	-0.266 (0.291)	0.085 (0.130)	0.307 (0.308)	-0.095 (0.359)	0.278 (0.306)	0.085 (0.132)
<i>Intercept</i>	-4.131*** (0.616)	-4.595*** (0.223)	-5.280*** (0.385)	-5.150*** (0.442)	-5.318*** (0.411)	-4.853*** (0.215)
N	235	1,811	333	712	328	1,979
Adj. R-squared	0.754	0.611	0.668	0.590	0.674	0.640

**Panel C: Log of absolute value of permanent book-tax differences**

$$AUDFEE_t = \beta_0 + \beta_1 ABSPERM_t + \beta_2 OBS_t + \beta_3 TaxAvoid_t + \beta_4 ACC_t + \beta_5 ABSPERM_t * OBS_t + \beta_6 ABSPERM_t * TaxAvoid_t + \beta_7 ABSPERM_t * ACC_t + \beta_j \sum Controls_t + \varepsilon$$

Variable	(1) Securitization Matched	(2) Securitization S&P	(3) Lease Matched	(4) Lease S&P	(5) Combined Matched	(6) Combined S&P
<i>ABSPERM</i>	0.184*** (0.049)	0.083*** (0.014)	0.069 (0.043)	0.069*** (0.025)	0.084** (0.039)	0.103*** (0.015)
<i>OBS</i>	0.509** (0.222)	-0.316 (0.256)	-0.020 (0.163)	0.430** (0.216)	-0.011 (0.154)	0.288 (0.176)
<i>TaxAvoid</i>	1.173*** (0.412)	0.194 (0.163)	-0.548* (0.331)	0.072 (0.217)	-0.390 (0.401)	0.267 (0.165)
<i>ACC</i>	1.487** (0.736)	0.134 (0.171)	0.450 (0.414)	0.425 (0.347)	-0.066 (0.537)	0.328* (0.178)
<i>ABSPERM*OBS</i>	-0.115** (0.056)	0.074 (0.046)	-0.032 (0.044)	-0.097** (0.043)	-0.035 (0.042)	-0.058* (0.034)
<i>ABSPERM*TaxAvoid</i>	-0.236** (0.095)	-0.053* (0.030)	0.085 (0.099)	-0.054 (0.045)	0.052 (0.112)	-0.071** (0.031)
<i>ABSPERM*ACC</i>	-0.241* (0.133)	-0.032 (0.026)	-0.116 (0.080)	-0.088 (0.057)	-0.006 (0.103)	-0.072** (0.028)
<i>OPINION</i>	0.878*** (0.103)	-0.874*** (0.110)	0.457*** (0.129)		0.434*** (0.121)	-0.925*** (0.148)
<i>FOREIGN</i>	0.149*** (0.051)	0.302*** (0.038)	0.196** (0.077)	0.201*** (0.061)	0.247*** (0.072)	0.299*** (0.036)
<i>ln(ASSETS)</i>	0.496*** (0.046)	0.520*** (0.021)	0.564*** (0.034)	0.563*** (0.031)	0.535*** (0.035)	0.520*** (0.020)
<i>INV</i>	-1.342*** (0.316)	-0.543*** (0.147)	-0.133 (0.275)	-0.316 (0.238)	-0.162 (0.247)	-0.462*** (0.140)
<i>REC</i>	1.396*** (0.397)	2.571*** (0.209)	1.805*** (0.280)	2.999*** (0.329)	1.900*** (0.289)	2.558*** (0.193)
<i>LOSS</i>	0.226** (0.113)	0.166*** (0.043)	0.157* (0.089)	0.288*** (0.068)	0.220** (0.090)	0.189*** (0.040)
<i>PROFIT</i>	-1.453* (0.766)	-1.045*** (0.205)	-0.804** (0.408)	-0.445 (0.293)	-0.517 (0.422)	-0.887*** (0.185)
<i>BigN</i>	-0.114 (0.197)	0.096 (0.128)	0.328 (0.286)	-0.084 (0.359)	0.284 (0.233)	0.094 (0.131)
<i>Intercept</i>	-4.912*** (0.571)	-4.686*** (0.222)	-5.273*** (0.373)	-4.931*** (0.437)	-5.277*** (0.335)	-4.852*** (0.210)
N	241	1,861	333	736	370	2,046
Adj. R-squared	0.765	0.628	0.686	0.574	0.654	0.642

Robust standard errors are in parentheses. \*, \*\*, \*\*\* Indicate statistical significance at the 0.1, 0.05, and 0.01 levels, respectively.

This table presents the OLS regression result of the effect of off-balance-sheet financing on the relation between audit fees and book-tax differences. *AUDFEE* is the natural log of audit-related fees. In Panel A, *ABSBTD* is the natural log of the absolute value of total book-tax differences. *ABSBTD\*OBS*, *ABSBTD\*ACC*, and *ABSBTD\*TaxAvoid* are the interactions between *ABSBTD* and *OBS*, *ABSBTD* and *ACC*, and *ABSBTD* and *TaxAvoid*, respectively. In Panel B, *ABSTEMP* is the natural log of the absolute value of temporary book-tax

differences.  $ABSTEMP*OBS$ ,  $ABSTEMP*ACC$ , and  $ABSTEMP*TaxAvoid$  are the interactions between  $ABSTEMP$  and  $OBS$ ,  $ABSTEMP$  and  $ACC$ , and  $ABSTEMP$  and  $TaxAvoid$ , respectively. In Panel C,  $ABSPERM$  is the natural log of the absolute value of permanent book-tax differences.  $ABSPERM*OBS$ ,  $ABSPERM*ACC$ , and  $ABSPERM*TaxAvoid$  are the interactions between  $ABSPERM$  and  $OBS$ ,  $ABSPERM$  and  $ACC$ , and  $ABSPERM$  and  $TaxAvoid$ , respectively.

$OBS$  is an indicator variable which equals one if a firm reports a securitization gain (or synthetic lease) for a year, and zero otherwise.  $ACC$  is an indicator variable which equals one for firm-years in the top quintile of total accruals scaled by lagged assets, without synthetic leases or securitizations, and not in the  $TaxAvoid$  subsample, and zero otherwise.  $TaxAvoid$  is an indicator variable which equals one for firm-years in the lowest  $CashETRs$  quintile in the sample, without synthetic leases or securitizations, and not in the  $ACC$  subsample, and zero otherwise.  $OPINION$  is a dummy variable which equals 1 if an audit opinion other than an unqualified opinion is given in the current year, and 0 otherwise.  $FOREIGN$  is the ratio of foreign pre-tax income (item 273) to total pre-tax income (item 170).  $\ln(ASSETS)$  is the natural log of total assets (item 6).  $INV$  is the total value of inventory (item 3) scaled by assets (item 6).  $REC$  is the total value of receivables (item 2) scaled by assets (item 6).  $LOSS$  is a dummy variable which equals 1 if income before extraordinary items and discontinued operations (item 18 - item 66) is negative in the current or prior fiscal year, and 0 otherwise.  $PROFIT$  is firm profit which is measured by operating income (item 178) scaled by assets (item 6).  $BigN$  is a dummy variable with a value of one if the firm is audited by a Big 5 (including Arthur Anderson) accounting firm in the current fiscal year, and zero otherwise. For each regression, I control for year and industry effects and winsorize all continuous variables at 1 percent and 99 percent.

**TABLE 13**

**Regression of Ranked Securitization Gains on the Relation  
between Book-Tax Differences and Forecast Errors**

$$FE_{t+1} = \beta_0 + \beta_1 TB_t + \beta_2 AEM_t + \beta_3 TaxAvoid_t + \beta_4 OBSrank_t + \beta_5 TB_t * OBSrank_t + \beta_6 TB_t * AEM_t + \beta_7 TB_t * TaxAvoid_t + \beta_8 SIZE_t + \beta_9 MB_t + \beta_{10} \Delta FOL_{t+1} + \beta_{11} PYFE_t + \varepsilon$$

Variable	(1) Securitization Matched	(2) Securitization S&P
<i>TB</i>	0.005 (0.011)	0.008** (0.004)
<i>AEM</i>	-0.002 (0.010)	0.002 (0.003)
<i>TaxAvoid</i>	0.006 (0.011)	0.003 (0.002)
<i>OBSrank</i>	0.002 (0.002)	0.001 (0.002)
<i>TB*OBSrank</i>	-0.002 (0.003)	-0.002 (0.003)
<i>TB*AEM</i>	0.014 (0.015)	-0.003 (0.005)
<i>TB*TaxAvoid</i>	-0.029 (0.036)	-0.003 (0.004)
<i>SIZE</i>	0.002 (0.001)	0.001* (0.001)
<i>MB</i>	0.002* (0.001)	0.000*** (0.000)
<i>ΔFOL</i>	0.015** (0.007)	0.011*** (0.003)
<i>PYFE</i>	0.146* (0.084)	0.209*** (0.061)
<i>Intercept</i>	0.005 (0.017)	-0.018*** (0.007)
Observations	335	3,152
Adj. R-squared	0.165	0.109

Robust standard errors are in parentheses. \*, \*\*, \*\*\* Indicate statistical significance at the 0.1, 0.05, and 0.01 levels, respectively.

This table presents the result of OLS regression of sources of securitization gains on the relation between such differences and forecast errors based on ranked securitization gains. The dependent variable, *FE*, is a firm's actual earnings in year *t* + 1 minus the consensus forecasted earnings deflated by stock price. *TB* is decile rank of the ratio of net tax income to net book income scaled to vary between zero and one. Net tax income is measured as (TAX/STR) \* (1 - STR), where STR is the top U.S. statutory corporate tax rate and TAX is current tax expense. TAX is measured as the sum of current federal (item 63) and foreign (item 64) income taxes, or, when either of

these amounts is missing, as total income tax expense (item 16) less deferred tax expense (item 50). Net book income is earnings before extraordinary items (item 18). *TaxAvoid* is an indicator variable which equals one for firm-year observations within the positive book-tax differences group and with CashETRs in the lowest quintile of all firm-years in the sample and not in the *OBS* subsample, and zero otherwise. *AEM* is an indicator variable which equals one for firm-year observations within the total (temporary or permanent) book-tax differences group and with modified Jones model discretionary accruals in the top quintile of all firm-years and not in the *OBS* or *TaxAvoid* subsample, and zero otherwise. *OBSrank* is the quintile rank of scaled securitization gains. *TB\*OBSrank*, *TB\*AEM*, and *TB\*TaxAvoid* are the interactions between *TB* and *OBSrank*, *TB* and *AEM*, and *TB* and *TaxAvoid*, respectively. *PYFE* is the actual earnings minus the median individual forecasted earnings from mid-year of year *t*, deflated by stock price.  $\Delta FOL$  is the change in the number of analysts who make earnings forecasts for a particular firm from year *t* to year *t* + 1, divided by the number from year *t*. *MB* is the ratio of CAP to book value of common equity (item 216). *SIZE* is the natural log of market capitalization (CAP) measured at year end (item 199  $\times$  item 54). For all regressions, I control for year and industry effects and winsorize all continuous variables at 1 percent and 99 percent.

TABLE 14

**Regression of Ranked Securitization Gains on the Relation  
between Book-Tax Differences and Audit Fees**

**Panel A: Log of absolute value of total book-tax differences**

$$AUDFEE_t = \beta_0 + \beta_1 ABSBTD_t + \beta_2 OBSrank_t + \beta_3 TaxAvoid_t + \beta_4 ACC_t + \beta_5 ABSBTD_t * OBSrank_t + \beta_6 ABSBTD_t * TaxAvoid_t + \beta_7 ABSBTD_t * ACC_t + \beta_j \sum Controls_t + \varepsilon$$

Variable	(1) Securitization Matched	(2) Securitization S&P
<i>ABSBTD</i>	0.142** (0.066)	0.055*** (0.020)
<i>OBSrank</i>	0.066 (0.071)	-0.055 (0.080)
<i>TaxAvoid</i>	1.031* (0.578)	0.118 (0.163)
<i>ACC</i>	-0.015 (0.036)	1.012*** (0.019)
<i>ABSBTD*OBSrank</i>	-0.014 (0.017)	0.013 (0.014)
<i>ABSBTD*TaxAvoid</i>	-0.180 (0.123)	-0.038 (0.030)
<i>ABSBTD*ACC</i>	0.028 (0.036)	-0.016** (0.008)
<i>OPINION</i>	0.757*** (0.130)	-0.777*** (0.160)
<i>FOREIGN</i>	0.169*** (0.052)	0.311*** (0.039)
<i>Ln(ASSETS)</i>	0.497*** (0.058)	0.548*** (0.025)
<i>INV</i>	-1.568*** (0.319)	-0.588*** (0.150)
<i>REC</i>	1.701*** (0.416)	2.526*** (0.206)
<i>LOSS</i>	0.350*** (0.095)	0.265*** (0.040)
<i>PROFIT</i>	-0.563* (0.290)	-0.969*** (0.204)
<i>BigN</i>	-0.086 (0.224)	0.135 (0.138)
<i>Intercept</i>	-4.833*** (0.619)	-5.015*** (0.240)
<i>Observations</i>	241	1,862
<i>Adj. R-squared</i>	0.745	0.630

Robust standard errors are in parentheses. \*, \*\*, \*\*\* Indicate statistical significance at the 0.1, 0.05, and 0.01 levels, respectively.

**Panel B: Log of absolute value of temporary book-tax differences**

$$AUDFEE_t = \beta_0 + \beta_1 ABSTEMP_t + \beta_2 OBSrank_t + \beta_3 TaxAvoid_t + \beta_4 ACC_t + \beta_5 ABSTEMP_t * OBSrank_t + \beta_6 ABSTEMP_t * TaxAvoid_t + \beta_7 ABSTEMP_t * ACC_t + \beta_j \sum Controls_t + \varepsilon$$

Variable	(1) Securitization Matched	(2) Securitization S&P
<i>ABSTEMP</i>	0.219*** (0.083)	0.018 (0.024)
<i>OBSrank</i>	0.077 (0.055)	-0.043 (0.075)
<i>TaxAvoid</i>	0.583** (0.237)	0.075 (0.113)
<i>ACC</i>	1.086*** (0.404)	0.099 (0.158)
<i>ABSTEMP*OBSrank</i>	-0.024 (0.020)	0.010 (0.018)
<i>ABSTEMP*TaxAvoid</i>	-0.131 (0.089)	-0.044 (0.029)
<i>ABSTEMP*ACC</i>	-0.202* (0.106)	-0.032 (0.030)
<i>OPINION</i>	0.824*** (0.118)	0.498 (1.212)
<i>FOREIGN</i>	0.167*** (0.054)	0.326*** (0.039)
<i>Ln(ASSETS)</i>	0.444*** (0.055)	0.589*** (0.021)
<i>INV</i>	-1.502*** (0.306)	-0.695*** (0.151)
<i>REC</i>	1.664*** (0.420)	2.777*** (0.223)
<i>LOSS</i>	0.222* (0.114)	0.250*** (0.046)
<i>PROFIT</i>	-1.646** (0.805)	-1.056*** (0.208)
<i>BigN</i>	-0.251 (0.290)	0.053 (0.127)
<i>Intercept</i>	-4.161*** (0.635)	-4.926*** (0.243)
<i>Observations</i>	235	1,847
<i>Adj. R-squared</i>	0.750	0.645

Robust standard errors are in parentheses. \*, \*\*, \*\*\* Indicate statistical significance at the 0.1, 0.05, and 0.01 levels, respectively.

**Panel C: Log of absolute value of permanent book-tax differences**

$$AUDFEE_t = \beta_0 + \beta_1 ABSPERM_t + \beta_2 OBSrank_t + \beta_3 TaxAvoid_t + \beta_4 ACC_t + \beta_5 ABSPERM_t * OBSrank_t + \beta_6 ABSPERM_t * TaxAvoid_t + \beta_7 ABSPERM_t * ACC_t + \beta_j \sum Controls_t + \varepsilon$$

Variable	(1) Securitization Matched	(2) Securitization S&P
<i>ABSPERM</i>	0.066*** (0.021)	0.211*** (0.060)
<i>OBSrank</i>	-0.099 (0.074)	0.127** (0.060)
<i>TaxAvoid</i>	0.170 (0.161)	1.131*** (0.406)
<i>ACC</i>	0.001 (0.180)	1.443* (0.739)
<i>ABSPERM*OBSrank</i>	0.020 (0.013)	-0.031** (0.015)
<i>ABSPERM*TaxAvoid</i>	-0.051* (0.030)	-0.231** (0.094)
<i>ABSPERM*ACC</i>	-0.012 (0.028)	-0.234* (0.133)
<i>OPINION</i>	0.189 (0.898)	0.867*** (0.111)
<i>FOREIGN</i>	0.320*** (0.039)	0.145*** (0.052)
<i>Ln(ASSETS)</i>	0.540*** (0.022)	0.491*** (0.047)
<i>INV</i>	-0.616*** (0.147)	-1.339*** (0.312)
<i>REC</i>	2.777*** (0.213)	1.393*** (0.399)
<i>LOSS</i>	0.203*** (0.045)	0.235** (0.112)
<i>PROFIT</i>	-1.136*** (0.205)	-1.489* (0.772)
<i>BigN</i>	0.069 (0.126)	-0.104 (0.198)
<i>Intercept</i>	-4.774*** (0.241)	-4.936*** (0.593)
<i>Observations</i>	1,897	241
<i>Adj. R-squared</i>	0.653	0.754

Robust standard errors are in parentheses. \*, \*\*, \*\*\* Indicate statistical significance at the 0.1, 0.05, and 0.01 levels, respectively.

This table presents the OLS regression result of the effect of securitization gains on the relation between audit fees and book-tax differences using securitization gains. *AUDFEE* is the natural log of audit-related fees. In Panel A, *ABSBTD* is the natural log of the absolute value of total book-tax differences. *ABSBTD\* OBSrank*, *ABSBTD\*ACC*, and *ABSBTD\*TaxAvoid* are the interactions between *ABSBTD* and *OBSrank*, *ABSBTD* and *ACC*, and *ABSBTD* and *TaxAvoid*, respectively. In Panel B, *ABSTEMP* is the natural log of the absolute value of temporary book-tax



differences.  $ABSTEMP*OBSrank$ ,  $ABSTEMP*ACC$ , and  $ABSTEMP*TaxAvoid$  are the interactions between  $ABSTEMP$  and  $OBSrank$ ,  $ABSTEMP$  and  $ACC$  and  $ABSTEMP$  and  $TaxAvoid$ , respectively. In Panel C,  $ABSPERM$  is the natural log of the absolute value of permanent book-tax differences.  $ABSPERM OBSrank$ ,  $ABSPERM*ACC$ , and  $ABSPERM*TaxAvoid$  are the interactions between  $ABSPERM$  and  $OBSrank$ ,  $ABSPERM$  and  $ACC$ , and  $ABSPERM$  and  $TaxAvoid$ , respectively.  $OBSrank$  is the quintile rank of scaled securitization gains.  $ACC$  is an indicator variable which equals one for firm-years in the top quintile of total accruals scaled by lagged assets, without synthetic leases or securitizations, and not in the  $TaxAvoid$  subsample, and zero otherwise.  $TaxAvoid$  is an indicator variable which equals one for firm-years in the lowest  $CashETRs$  quintile in the sample, without synthetic leases or securitizations, and not in the  $ACC$  subsample, and zero otherwise.  $OPINION$  is a dummy variable which equals 1 if an audit opinion other than an unqualified opinion is given in the current year, and 0 otherwise.  $FOREIGN$  is the ratio of foreign pre-tax income (item 273) to total pre-tax income (item 170).  $ln(ASSETS)$  is the natural log of total assets (item 6).  $INV$  is the total value of inventory (item 3) scaled by assets (item 6).  $REC$  is the total value of receivables (item 2) scaled by assets (item 6).  $LOSS$  is a dummy variable which equals 1 if income before extraordinary items and discontinued operations (item 18 - item 66) is negative in the current or prior fiscal year, and 0 otherwise.  $PROFIT$  is firm profit which is measured by operating income (item 178) scaled by assets (item 6).  $BigN$  is a dummy variable with a value of one if the firm is audited by a Big 5 (including Arthur Anderson) accounting firm in the current fiscal year, and zero otherwise. For each regression, I control for year and industry effects and winsorize all continuous variables at 1 percent and 99 percent.

TABLE 15

**Regression Analysis of the Effect of Off-Balance-Sheet Financing on Book-Tax Differences  
with Alternative Cash Effective Tax Rates**

(Dependent variables: Column (1) = *BTD*; Column (2) = *TEMP*; Column (3) = *PERM*)

Variable	(1) <i>BTD</i>	(2) <i>TEMP</i>	(3) <i>PERM</i>
<i>Secu_Gain</i>	0.017** (0.008)	0.000 (0.006)	0.015* (0.008)
<i>CashETR_Alt</i>	-0.010 (0.017)	-0.021 (0.013)	0.012 (0.016)
<i>DISACC</i>	0.186*** (0.043)	0.008 (0.021)	0.172*** (0.042)
<i>Growth</i>	0.018 (0.011)	0.001 (0.004)	0.015 (0.012)
<i>NOL</i>	0.844*** (0.112)	-0.006 (0.030)	0.837*** (0.108)
<i>LOSS</i>	-0.045*** (0.011)	-0.010 (0.011)	-0.030** (0.014)
<i>FOREIGN</i>	0.001*** (0.000)	-0.001*** (0.000)	0.002*** (0.000)
<i>NPPE</i>	-0.024 (0.023)	-0.002 (0.013)	-0.020 (0.018)
<i>Intang</i>	0.021*** (0.007)	0.010 (0.008)	0.011* (0.007)
<i>Equity</i>	-0.282 (1.473)	-0.189 (0.813)	0.045 (0.850)
<i>MI</i>	1.938** (0.893)	1.589 (1.252)	0.445 (1.059)
<i>LAGBTD</i>	0.084 (0.052)		
<i>LAGTEMP</i>		0.168*** (0.062)	
<i>LAGPERM</i>			0.146** (0.065)
<i>Intercept</i>	0.025 (0.019)	0.025 (0.015)	-0.000 (0.009)
Observations	276	276	273
Adj. R-squared	0.690	0.027	0.753

Robust standard errors are in parentheses. \*, \*\*, \*\*\* Indicate statistical significance at the 0.1, 0.05, and 0.01 levels, respectively.

This table presents the result of OLS regression of the effect of off-balance-sheet financing on book-tax differences based on an alternative measure of cash effective tax rates. In Column (1), the dependent variable, *BTD*, is the total book-tax difference, which equals book income less estimated taxable income scaled by average book assets (COMPUSTAT item 6). Book income is pretax income (item 170). Estimated taxable income is calculated by summing the current federal tax expense (item 63) and current foreign tax expense (item 64) and dividing by the 35% statutory tax rate (STR) and then subtracting the change in NOL carryforwards (item 52). If current the federal tax expense is missing, the total current tax expense is calculated by subtracting deferred taxes (item 50), state income taxes (item 173), and other income taxes (item 211) from the total income taxes (item 16). In Column (2), the dependent variable, *TEMP*, is temporary book-tax difference, which is the sum of U.S (item 269) and foreign (item 270) deferred tax divided by the 35% statutory rate and then scaled by lagged total assets (item 6). In Column (3), the dependent variable, *PERM*, is permanent book-tax difference which equals *BTD* less *TEMP*. *LAGBTD*, *LAGTEMP*, and *LAGPERM* are the lagged *BTD*, *TEMP*, and *PERM*, respectively. *Secu\_Gain* is the value of securitization gains scaled by lagged assets. *CashETR\_Alt* is the residual from the regression in which *CashETR* is regressed on *Secu\_Gain*. *CashETR* is the five-year effective cash tax rate, which equals sum of cash taxes paid (item 317) over the previous 5 years divided by the sum of pretax income (item 170 - item 17) over the previous 5 years (or 3 years if 5 years of data are unavailable). *DISACC* is discretionary accruals measured as the residual from the modified Jones model. *Growth* is the change in net sales (item 12) scaled by lagged assets.  $\Delta$ *NOL* is the change in net operating loss carryforwards (item 52) scaled by lagged assets. *Loss* is an indicator variable which equals one if a firm reports negative pretax income and zero otherwise (item 170 - item 17). *Foreign* is the amount of foreign pretax earnings (item 273) scaled by total pretax earnings (item 170). *NPPE* is the ratio of net property, plant and equipment (item 8) to gross property, plant and equipment (item 7). *Intang* is sum of goodwill (item 204) and other intangibles (item 33) scaled by lagged assets. *Equity* is income or loss attributable to the equity method (item 55) scaled by lagged assets. *MI* is income or loss attributable to minority interests (item 49) scaled by lagged assets. For each regression, I control for year and industry effects and winsorize all continuous variables at 1 percent and 99 percent.

VITA

Tong (Robert) Yu

Candidate for the Degree of

Doctor of Philosophy

Thesis: OFF-BALANCE-SHEET FINANCING, BOOK-TAX DIFFERENCES AND  
FIRM ATTRIBUTES

Major Field: Accounting

Biographical:

Education:

Completed the requirements for the Doctor of Philosophy/Education in your major at Oklahoma State University, Stillwater, Oklahoma in July, 2013.

Completed the requirements for the Master of Science in Accounting at Oklahoma State University, Stillwater, Oklahoma in July, 2006.

Completed the requirements for the Master of Science in Hospitality Administration at Oklahoma State University, Stillwater, Oklahoma in December, 2005.

Completed the requirements for the Bachelor of Economics in Tourism Management at Hangzhou University of Commerce, Hangzhou, Zhejiang in July, 1998.