The Effect of Shareholder Scrutiny on Corporate Tax Behavior: Evidence from Shareholder Tax Litigation

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July 2021

Abstract: This study examines the effect of *shareholder* scrutiny of tax issues on corporate tax behavior. Specifically, we examine the factors associated with receiving shareholder tax litigation and the effect of such litigation on the future tax behavior of both the sued firm and its peers. We find shareholder tax litigation is more likely when firms exhibit higher levels of tax avoidance and greater tax uncertainty. Further, sued firms decrease tax avoidance activities (increasing their cash and GAAP ETRs and reducing the likelihood of extreme tax avoidance) after the suit. Finally, we find a spillover effect from shareholder scrutiny over tax issues. That is, treatment firms from the same industry as sued firms increase their cash and GAAP ETRs and decrease their UTBs and instances of extreme tax avoidance relative to control firms after the sued firm's shareholder tax litigation, and results are strongest where theory predicts results to be concentrated.

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1. Introduction

This study examines *shareholder* scrutiny through litigation on corporate tax behavior. Shareholder tax litigation encompasses a variety of issues, including concerns over explicit taxes, tax financial reporting and disclosure, and other matters (Donelson et al. 2020). We examine the factors associated with the likelihood of shareholder tax litigation and the effect of this litigation on the future tax behavior of both the sued firm and its industry peers.

These questions are important for two primary reasons. First, shareholder tax litigation creates substantial economic and reputational risks for both firms and their stakeholders. For example, a recent securities class action lawsuit alleged that Pall Corporation improperly recognized a tax transaction and, consequently, misrepresented its effective tax rate (ETR). Following the lawsuit, the firm experienced a credit rating downgrade, stock price declines, and negative media attention.[1] Consistent with shareholder tax litigation posing significant costs to the sued firm, Donelson et al. (2020) find that director and officer (D&O) liability insurers price the risk of this litigation into firms' D&O insurance policies. Although still relatively rare, the incidence of shareholder tax litigation has grown substantially over time—increasing over 200 percent from 1996-2007 to 2008-2018 (see Section 2.1). Importantly, the reach of litigation may extend beyond the sued firms and spill over to the firm's peers. Specifically, to the extent that managers of peer firms modify their tax activities in response to litigation against a similar firm, shareholder tax litigation has the potential to broadly influence corporate tax planning and reporting across multiple firms. Moreover, these effects may aid the IRS' and SEC's efforts of curbing aggressive tax avoidance and unclear or misleading tax disclosures, respectively, since private enforcement complements public enforcement (Schantl and Wagenhofer 2020).

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[1] See http://securities.stanford.edu/filings-case.html?id=10380.

Second, whether and how shareholder tax litigation affects firm and peer behavior expands our understanding of the mechanisms used to constrain agency costs of tax avoidance (e.g., Chen and Chu 2005). Although investors price tax avoidance and disclosure into their valuation decisions (Goh et al. 2016; Hanlon and Slemrod 2009; Wilson 2009), there is limited empirical evidence on the direct mechanisms shareholders use to monitor corporate tax policies they view as detrimental. As a key corporate governance mechanism, litigation can mitigate agency costs by constraining behavior that shareholders believe harms firm value (Donelson and Yust 2014). For example, securities class actions and derivative litigation against a firm and its managers and directors can target aggressive tax avoidance strategies (e.g., tax shelters).

To investigate our research questions, we examine shareholder tax litigation from 1996 through 2018. Because allegations in shareholder tax litigation commonly involve both tax avoidance strategies and tax financial reporting (Donelson et al. 2020), we use several proxies to capture different aspects of tax avoidance. These proxies include cash and generally accepted accounting principles (GAAP) ETRs and uncertain tax benefits (UTBs). We also use binary measures of cash and GAAP ETRs to investigate instances of extreme tax avoidance in which firms' ETRs are in the lowest tercile of the distribution (see Dyreng et al. 2019). To the extent that firms assume greater risk to maintain low ETRs (Armstrong et al. 2015), these extreme tax avoiders may not only incur greater litigation risk but also be more sensitive to the potential costs of shareholder tax litigation.

We first examine the association between these lagged tax measures and the likelihood of shareholder tax litigation filings. We find a negative association between future tax litigation and GAAP ETRs and a positive association for UTBs and cash and GAAP extreme tax avoidance. However, we find no evidence of a relation between tax litigation and cash ETRs. Collectively,

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these results suggest that tax litigation is more likely when firms engage in greater levels of tax avoidance and exhibit higher levels of tax uncertainty.

We next examine whether sued firms reduce tax avoidance after the filing of shareholder tax litigation. We expect that litigation increases the cost of future tax avoidance for sued firms through increased reputational risk for managers and the firm itself and the threat of additional scrutiny from tax authorities and regulators. Due to these higher future costs, the equilibrium level of tax avoidance may decline. Similarly, the financial reporting of tax activities may improve. To investigate, we compare the subsequent tax behavior of firms with shareholder tax litigation to that of firms with *non-tax* shareholder litigation. That is, we hold shareholder litigation constant, enabling us to isolate the specific effect of shareholder scrutiny of tax issues. To mitigate the likelihood that results are due to concurrent changes in other financial reporting or business operations, we use entropy balancing to ensure treatment and control firms are similar on observable dimensions. Using a difference-in-differences design, we find sued firms increase their cash and GAAP ETRs and have a lower likelihood of extreme cash and GAAP tax avoidance after tax litigation, but we find no evidence of an effect for UTBs. Overall, results indicate that shareholder scrutiny over tax issues leads sued firms to decrease tax avoidance.

Finally, we investigate spillover effects of shareholder tax litigation. Since firms often mimic peers' tax strategies (Bird et al. 2018; Kubick et al. 2015), peer firms may also decrease tax avoidance after tax litigation in their industry due to fear of similar litigation. We define treatment firms as peers of the sued firm in the highest tercile of litigation risk and control firms as peers in the lowest tercile of litigation risk (Donelson et al. 2021a). Thus, control firms are subject to similar industry-wide economic factors as treatment firms but should not respond to the increase in litigation risk as they face minimal risk of being sued. Similar to our prior

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analysis, we use a difference-in-differences design and entropy balancing. We find treatment firms increase cash and GAAP ETRs and decrease UTBs and the likelihood of extreme cash and GAAP tax avoidance after the sued firm's tax-related litigation, consistent with a spillover effect.

To provide additional insight, we exploit cross-sectional variation to test if the spillover effect is strongest where theory would predict results to be concentrated. Sued firms with product market power and abnormal media coverage around the litigation filing date should experience stronger spillover effects since peer firms mimic tax strategies of product market leaders (Kubick et al. 2015) and media coverage increases the visibility of information regarding the sued firms' alleged misconduct (Bednar et al. 2013; Zavyalova et al. 2012). Consistent with this notion, we find that peer firms increase their cash and GAAP ETRs and decrease their likelihood of extreme cash and GAAP tax avoidance following shareholder tax litigation when the sued firm is a product market leader or is highly covered in the media. In contrast, we find little evidence of a spillover effect when the sued firm has little product market power within their industry or has relatively low media coverage. These results suggest that sued firms' visibility affects the extent to which their peers reduce their tax avoidance behavior following shareholder tax litigation.

Finally, although the overlap between shareholder tax litigation in our sample and tax authority and regulatory enforcement is relatively minimal, we conduct several untabulated robustness tests to ensure that our results are not attributable to non-shareholder tax litigation or tax-related SEC comment letters. Specifically, we separately re-estimate our tests after excluding shareholder tax litigation triggered by tax authorities or other government actions (e.g., IRS audits) or followed by regulatory actions (e.g., SEC enforcement) and after controlling for the receipt of a tax-related SEC comment letter. We obtain similar results across all specifications, indicating that our results are not due to these alternative explanations.

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This study contributes to the literature in several ways. First, we contribute to the literature on determinants and consequences of litigation (e.g., Kim and Skinner 2012; Rogers and Van Buskirk 2009). Specifically, we extend this literature to include tax-related litigation. In contrast to most non-tax litigation, tax litigation could curtail a legal, but risky, value-maximizing activity simply due to differences in managers' and investors' risk preferences.

Second, we contribute to the literature on how scrutiny of tax issues affects corporate tax behavior. Recent research explores the effects of scrutiny from the media, regulators, tax authorities, and non-governmental activists (Chen et al. 2019b; Dyreng et al. 2016; Hoopes et al. 2012; Kubick et al. 2016). We extend these studies by examining the influence of shareholder's tax litigation scrutiny and, thus, provide evidence on a direct mechanism that shareholders use to monitor corporate tax behavior. Only one study, to our knowledge, examines the effect of shareholder litigation on corporate tax policies. Arena et al. (2021) use a 1999 U.S. Circuit Court of Appeals ruling and find that lower securities litigation risk is associated with more tax avoidance. Our study differs from theirs in several important ways. First, we directly examine the effects of *filed* shareholder tax litigation (both derivative and securities class actions) on sued firm tax behavior, as opposed to merely the *risk* of securities litigation. Second, while Arena et al. (2021) primarily find a tax reporting-based response to securities litigation risk, our findings suggest that tax litigation reduces *several* aspects of tax avoidance, including cash taxes paid to tax authorities, tax financial reporting, and tax uncertainty. Finally, we examine the determinants and indirect spillover effects of shareholder tax litigation, as opposed to only a direct effect.

Third, we inform on effects of spillover on tax behavior. Prior research focuses on the spillover effects of SEC scrutiny on peers' tax avoidance (Kubick et al. 2016). We extend this line of research by examining the spillover effects of shareholder tax litigation. In combination,

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our results suggest that shareholder tax litigation has a direct effect on the sued firm and an indirect effect on peer firms, which is consistent with private litigation complementing both the IRS' and SEC's tax-related enforcement. Given recent evidence that internal resource constraints have negative effects on IRS tax enforcement and SEC monitoring of firm financial statements, including tax disclosure (e.g., Ege et al. 2020; Nessa et al. 2020), this evidence should be of particular interest to regulators and tax policy makers.

Finally, we contribute to the literature on the relation between reputation and tax avoidance. Despite survey evidence that executives are concerned with reputational harm from tax avoidance, empirical evidence on the relation is mixed (e.g., Asay et al. 2021; Austin and Wilson 2017; Gallemore et al. 2014; Graham et al. 2014; Hanlon and Slemrod 2009). Our evidence that tax-related litigation has meaningful effects on both sued firms and their peers, suggesting firms perceive shareholder scrutiny as increasing reputational costs of tax avoidance.

2. Background, related literature and hypothesis development

2.1. Magnitude of and trends in shareholder tax litigation

Table 1, Panel A shows there are 123 shareholder tax-related cases filed against 102 public firms from 1996-2018.[2] In terms of economic magnitude, this litigation accounted for $950 million in settlements, with 21 cases still pending, although total litigation costs likely exceed $1.27 billion after adding defense costs (Donelson et al. 2015). Moreover, as shown in Figure 1, the incidence of shareholder tax litigation has significantly increased over time. For example, using the breakpoint around FASB Interpretation No. 48 from Donelson et al. (2020),

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[2] To identify firms with shareholder tax litigation, we follow Donelson et al. (2020) and begin with all shareholder cases that include the word "tax" in the Advisen case description. We then read each description and docket, if needed, to ensure all cases contain tax-related allegations. We classify the primary allegation(s) in each case based on whether the underlying tax activity that triggered the case was 1) explicit tax focused, 2) tax reporting focused, 3) both explicit tax and tax reporting focused, or 4) other (e.g., objections to proposed merger and acquisitions).

the number of shareholder tax litigation cases increased from 34 cases filed from 1996-2007 to 89 cases from 2008-2018, which equates to more than a 189 percent increase in the annual litigation rate and is significantly different (2.8 versus 8.1, t-stat = -3.87, untabulated).

Although the incidence of shareholder tax litigation is small relative to other sources of tax scrutiny, such as SEC comment letters (e.g., Kubick et al. 2016), the economic effects of this litigation is significant. For example, Donelson et al. (2021b) find a negative five percent abnormal return around the Wall Street Journal's coverage of the stock option backdating scandal, which involved significant tax-related allegations (Bernile and Jarrell 2009) and resulted in numerous securities class actions and derivative suits (e.g., see Panel B of Table 2). Similarly, Donelson and Yust (2019) find a negative return ranging from one to six percent around the filing date for securities class actions, depending on the specification. In comparison, Dechow et al. (2016) document a -0.265 percent return on the release date for revenue recognition comment letters, an arguably more important type of SEC comment letter. Thus, despite the lower frequency of shareholder tax litigation, its effects can be just as, if not more, economically significant than other sources of scrutiny (e.g., comment letters).

2.2. Types of shareholder tax litigation

Shareholder tax litigation includes derivative litigation and securities class actions. In derivative litigation, a shareholder sues the firm's managers and/or directors in the firm's name, alleging managers failed to act in the best interest of the firm. These allegations include engaging in aggressive tax strategies (e.g., tax shelters), failing to pay taxes the firm was legally required to pay, and improperly accounting for tax information in the firm's financial statements (Donelson et al. 2020). Similarly, securities class actions most commonly involve allegations of misreporting or improperly accounting for tax information in the financial statements (e.g.,

failing to book a valuation allowance against deferred tax assets when evidence suggests the tax benefits will not be realized in future periods).[3] Appendix A provides examples of each type of shareholder tax litigation.[4] As shown in Panel B of Table 1, our sample of tax litigation is fairly evenly split between securities class actions (54 percent) and derivative litigation (46 percent).

In addition to the distinct types of shareholder tax litigation, allegations in tax litigation encompass three types of tax activities: explicit taxes, tax financial reporting, and other issues (Donelson et al. 2020). Litigation involving explicit tax issues typically involves allegations about the firm's tax liability paid to U.S. or foreign tax authorities, including aggressive tax strategies (e.g., income shifting to subsidiaries in countries with low or no tax), or issues with how the firm treated certain transactions for tax purposes. In contrast, tax reporting issues generally allege firms managed earnings by manipulating the tax accounts. Cases involving other issues typically involve shareholder tax implications of inversion transactions. As shown in Panel C of Table 1, explicit tax issues account for approximately 65 percent of tax litigation in our sample, while tax reporting (other) issues are cited in roughly 46 (7) percent of cases.

Panel A of Table 2 presents the types of tax activities cited in shareholder tax litigation. The most common types of tax activity in these cases are accounting for income tax issues, issues regarding the deductibility of executive compensation, and income shifting through foreign subsidiaries. As shown in Panel B of Table 2, the most common triggering events for shareholder tax litigation are restatement or other firm announcements; disclosures regarding information about the firm's financial condition, errors, or wrongdoing; and shareholder challenges over the deductibility of executive compensation. Importantly, only ten percent of

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[3] Securities class actions usually have individual shareholders as the lead plaintiff, although institutional investors, such as pension funds, also commonly act as the lead plaintiff (Donelson et al. 2015).
[4] See Appendix A of Donelson et al. (2020) for additional examples of each type of shareholder tax litigation.

cases are triggered by information revealed during IRS, foreign, or state tax authority audits or investigations, similar to that reported by Donelson et al. (2020). In addition, a similarly small minority of cases (approximately nine percent) of cases are prompted by regulatory litigation (i.e., SEC, DOJ, foreign, and other state or federal agencies). Thus, shareholder tax litigation is largely distinct from tax authority or regulatory challenges.

2.3. Determinants of shareholder tax litigation

Several studies identify a variety of firm-level characteristics associated with the likelihood of shareholder litigation. For instance, Kim and Skinner (2012) find that firms that are larger; have more sales growth, stock volatility, and share turnover; have low return skewness; and are in high litigation industries are more likely to receive a securities class action. Similarly, Ferris et al. (2007) find that derivative litigation is positively associated with stock return volatility, market valuations, and free cash flow and is negatively associated with performance.

Additionally, a firm's prior tax avoidance behavior may also affect its likelihood of shareholder tax litigation. As discussed in Section 2.1, shareholder tax litigation most commonly involves allegations that firms invested in overly risky tax planning strategies and/or failed to properly account for and disclose the financial reporting implications of certain tax transactions. It is relatively intuitive that firms that exhibit greater tax avoidance, such as using aggressive tax reduction strategies, have a higher risk of being targeted by both tax authorities and shareholder litigation. However, shareholders seeking to bring litigation related to a firm's financial reporting may also focus on a firm's tax avoidance strategies since shareholders can allege that the firm did not properly disclose or account for certain explicit tax issues. Consistent with tax avoidance and tax financial reporting issues being inextricably linked, Balakrishnan et al. (2019) find that firms that are more tax aggressive have less transparent information environments. In addition,

although Balakrishnan et al. (2019) find that firms increase tax-related disclosures in an effort to improve transparency, the increase in tax disclosure does not eliminate the opacity created by tax planning activities. Thus, we expect that the level of a firm's tax avoidance will increase the likelihood of shareholder tax litigation. We state this hypothesis in the alternative as follows:

H1: Tax avoidance is positively associated with shareholder tax litigation.

2.4. *The effect of shareholder scrutiny on sued firms' tax avoidance*

Corporations invest in tax avoidance to increase firm value, net income, and cash flow (Rego and Wilson 2012). However, engaging in tax avoidance can be costly from a non-tax perspective, potentially exposing the firm to significant political and reputational costs (Scholes et al. 2015). For example, tax avoidance can damage a firm's brand and reputation, lead to shareholder criticism, and impair the firm's relationship with tax authorities (EY 2014). Indeed, tax practitioners often stress the importance to firms of choosing tax strategies that not only fall within the tax law but are also fair and equitable to all of the firm's stakeholders, including shareholders (EY 2017). Survey evidence supports the view that firms and managers consider political and reputational costs when evaluating tax avoidance opportunities. For example, Graham et al. (2014) report that nearly 70 percent of executive respondents cite potential harm to their firm's reputations as a reason for not engaging in certain tax planning strategies.

Consistent with this evidence, Hanlon and Slemrod (2009) find a negative relation between stock returns and the revelation of tax shelter usage, implying that shareholders perceive tax aggressiveness to be costly and accordingly penalize these firms. However, Gallemore et al. (2014) find that these penalties subsequently reverse within a few weeks of the revelation, suggesting that reputational damage stemming from certain tax avoidance strategies may be short-lived. Moreover, Asay et al. (2021) find little evidence that consumers change their

purchasing behavior after news about corporate tax avoidance, inconsistent with tax strategies damaging firms' brands and reputations.

Despite the mixed evidence above, a growing stream of studies document that scrutiny from various firm stakeholders affects corporate tax behavior. For example, Hoopes et al. (2012) find a positive relation between ETRs and the likelihood of an IRS audit, consistent with greater IRS scrutiny tempering corporate tax avoidance. Focusing on the role of regulatory scrutiny, Kubick et al. (2016) document that the resolution of a tax-related comment letter from the SEC is negatively associated with firm and peer tax avoidance. In addition to scrutiny from the IRS and SEC, prior research also investigates the effect of scrutiny from other firm monitors, including non-profit activist organizations and the media. Dyreng et al. (2016) find that firms which failed to comply with a subsidiary disclosure rule in the United Kingdom subsequently engage in less tax avoidance relative to compliant firms after ActionAid International publicly revealed the noncompliance. However, Chen et al. (2019b) fail to find evidence that media coverage has a meaningful effect on firm tax avoidance, suggesting media scrutiny may not have as strong of an effect on firm tax behavior as that from other stakeholders.

Although prior literature examines the relation between corporate tax policy and scrutiny from non-governmental activist groups, the media, regulators, and tax authorities, far less is known about the direct mechanisms through which shareholders scrutinize firm tax policy. Prior studies in this area generally provide indirect or anecdotal evidence of instances of shareholder scrutiny of tax avoidance behavior, with little focus on how shareholders contest tax decisions they believe harm firm value. For example, using stock liquidity to examine the effect of unobservable shareholder actions on firm tax behavior, Chen et al. (2019c) find stock liquidity is negatively associated with tax avoidance, suggesting that stock liquidity constrains extreme tax

avoidance by increasing shareholder monitoring. Similarly, Rego et al. (2021) use retail trading data and find that individual investors own less stock of firms that engage in greater tax avoidance. Other studies examine the effect of activist interventions or institutional investors on tax outcomes (e.g., Chen et al. 2019a; Cheng et al. 2012; Khan et al. 2017). While these studies argue that investors improve tax planning efficiency through their ownership stakes and the threat of exit or voice, they provide little direct empirical evidence of these mechanisms. In contrast, by examining whether sued firms and their peers change their tax avoidance behavior following shareholder tax litigation, we provide direct evidence on a mechanism that shareholders use to scrutinize and affect corporate tax policy.

Shareholder litigation can be costly, potentially increasing future litigation risk (Core 1997) and exposing the firm to increased public attention and reputational damage (Simmons 2011), as well as the threat of additional litigation and scrutiny from tax authorities and regulators. Moreover, the increasing prevalence of media coverage of corporate taxes (see Chen et al. 2019b) may facilitate shareholder discovery of litigious tax issues, further exacerbating the costs of shareholder tax litigation. Thus, we expect that shareholder tax litigation increases the non-tax costs of future tax avoidance for sued firms. As a result of these higher future costs, we expect the firm's level of tax avoidance to decline and the financial reporting of tax activities to improve. We state this hypothesis in the alternative as follows:

H2: Shareholder tax litigation is negatively associated with future tax avoidance.

2.5. Spillover effects of shareholder scrutiny

Prior research suggests that firms adjust their levels of tax avoidance in response to their peers' tax avoidance decisions. For example, Kubick et al. (2015) find that firms mimic the tax outcomes of product market leaders to remain competitive in their industry. In addition, Brown

(2011) and Brown and Drake (2014) document the role of board interlocks and social networks, respectively, in facilitating the spread of tax avoidance strategies among firms and their peers. In a regulatory scrutiny context, Kubick et al. (2016) find that firms engage in less tax avoidance following the resolution of a peer firm's tax-related SEC comment letter. Similarly, shareholder scrutiny via tax-related litigation may also affect the tax avoidance of a sued firm's peers.

As previously discussed, shareholder litigation can entail significant costs, such as increased future litigation (Core 1997) and reputational damage (Simmons 2011). Because peer firms follow the news of other firms in their industry (Beatty et al. 2013), peer firms may perceive a sued firm's litigation as potentially increasing their own litigation risk or reputational costs and, therefore, change their tax behavior to mitigate these costs. Similarly, shareholders may expect firms in the same industry as a sued firm to have engaged in similar misconduct and increase their scrutiny accordingly (Gande and Lewis 2009). For example, Bauckloh et al. (2021) examine the European Commission's state aid investigations of private letter rulings and find that news about the potential loss of tax benefits among four large U.S. multinational corporations is associated with a negative stock price reaction among peer firms. Consistent with this, Donelson et al. (2021a) find that peer firms increase the readability of their financial disclosures and voluntary disclosure after an industry peer is targeted in a securities class action. We state this hypothesis in the alternative as follows:

H3: Shareholder tax litigation is negatively associated with peer firms' future tax avoidance.

However, there is reason to believe that both sued firms (H2) and peer firms (H3) may not change their tax avoidance behavior following shareholder tax litigation. First, although firms appear to change their tax avoidance behavior in response to regulatory, activist, and tax authority attention, other types of scrutiny, including negative media attention, appear to have

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little effect (Chen et al. 2019b). Second, to the extent that shareholder tax litigation signals to other market participants that the firm and its managers are actively trying to ensure that fewer of its resources are paid out to the government, firms may not change their behavior (Dyreng et al. 2016). Third, although the incidence of shareholder tax litigation has grown substantially over time, it is still in the minority of all litigation and, thus, may not be perceived by managers as a substantial non-tax cost that would necessitate changes in the equilibrium level of tax avoidance.

3. Sample and research design

3.1. Data and sample selection

To investigate our research questions, we use comprehensive litigation data from Advisen, as supplemented by the Stanford Securities Class Action Clearinghouse, financial statement data from Compustat, stock return data from CRSP, media articles from Factiva, restatement and comment letter data from Audit Analytics, compensation data from Execucomp, and governance data from Boardex for 1996 to 2019. We begin our sample in 1996, which was the first year after the Private Securities Litigation Reform Act of 1995 (PSLRA), to ensure a relatively constant litigation environment. We begin with all shareholder litigation (i.e., securities class actions and derivative cases) filed between 1996 and 2018 in Advisen. We require litigation to be filed by 2018 to ensure both sued and peer firms have sufficient data to investigate post-litigation effects. We exclude tax cases where the allegations do not involve explicit taxes or tax financial reporting (e.g., tax implications of a firm's mergers and acquisitions) to focus on the tax-related litigation most related to our proxies for tax avoidance and reporting. We also exclude tax cases which are preceded by regulatory litigation to ensure that results our attributable to shareholder tax litigation and not SEC or other regulator litigation.

Consistent with prior research (e.g., Kubick et al. 2016), we eliminate observations in the

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financial (SIC codes 6000-6999) and utility (SIC codes 4900-4999) industries because of their regulated nature. We also require all observations to have non-negative pretax book income and non-missing total tax expense and cash taxes paid since firms without these attributes may have less incentive to avoid taxes (Dyreng et al. 2008). Finally, we require each firm to have data necessary to compute all control variables and at least one firm-year observation before and after the litigation date of interest (the filing date for H1 and H3 and the class period end date for H2) to ensure our results are not due to changes in sample composition (Kubick et al. 2016). To mitigate the risk of outliers, we winsorize continuous variables at the 1st and 99th percentiles and censor ETR measures between zero and one.

3.2. Measures of tax avoidance

As discussed in Section 2.1, allegations in shareholder tax litigation commonly involve both tax planning strategies and tax financial reporting. Thus, we examine multiple measures that capture different facets of tax planning, including overall tax avoidance and tax uncertainty. We first focus on cash and GAAP ETRs (*CETR* and *GETR*, respectively) because these measures capture the allegations most cited in tax-related litigation (Donelson et al. 2020). Importantly, ETRs are visible measures readily found in firm's financial statements, earnings announcements, and conference calls, and thus are likely used by shareholders when assessing whether the firm is investing in tax avoidance in their best interest (McGuire et al. 2014).[5] As a measure of real tax planning, *CETR* reflects tax avoidance strategies that reduce cash taxes paid in the current period (computed as cash taxes paid scaled by pre-tax book income less special items). In contrast, *GETR* (computed as total tax expense scaled by pre-tax book income less special items) is the tax

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[5] Consistent with ETRs serving as a potential signal to shareholders of firm tax litigation risk, allegations in shareholder tax litigation often reference low ETRs as evidence of tax planning posing excessive risk to the firm and its shareholders. See http://securities.stanford.edu/filings-case.html?id=103800 for an example.

rate reflected on firm financial statements and captures tax avoidance that affects net income. Lower values of *CETR* and *GETR* reflect greater tax avoidance.

We also create binary measures of *CETR* and *GETR* to examine the relation between shareholder tax litigation and relatively extreme tax avoidance (Chen et al. 2019b). To the extent firms incur greater risk to maintain low ETRs (Armstrong et al. 2015), shareholders may target firms with the lowest ETRs to a greater degree. At the same time, firms that have relatively low ETRs may be more sensitive to the potential costs of shareholder tax litigation. We create two indicator variables, *TAVOIDER* (*GAVOIDER*), which equal one if the firm's *CETR* (*GETR*) is in the lowest tercile of the distribution, and zero otherwise (Dyreng et al. 2019).

Although both cash and GAAP ETRs are used to measure overall tax avoidance, they capture both benign tax planning (e.g., investing in municipal bonds) and aggressive—and likely more litigious—tax avoidance strategies (e.g., tax shelters). Thus, to capture grey-area tax planning that may entail greater uncertainty and thus expose the firm to a higher shareholder tax litigation risk, we also use UTBs. UTBs reflect tax positions the firm believes may result in additional taxes if challenged. Greater UTBs may increase tax litigation risk because their judgment-based nature may provide shareholders' lawyers with a roadmap to identify key areas of tax uncertainty that can be used to influence case selection and improve their settlement odds (Tyukody and Spindler 2008; Pickhardt 2006). In addition, UTBs are associated with aggressive tax shelter usage (Lisowsky et al. 2013), which shareholders may scrutinize as not only costly but also value-destroying. We compute *UTB* as the ending balance of UTBs scaled by lagged total assets. Greater values of *UTB* represent greater tax avoidance. However, we have less statistical power to detect a relation with UTBs as they are not available prior to fiscal year 2007.

3.3. Empirical models

3.3.1. Determinants of shareholder tax litigation research design (H1)

To explore the determinants of shareholder tax litigation, we estimate the following

logistic regression using firms sued by their shareholders for any reason (i.e., for tax-related

issues and non-tax issues):

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\begin{aligned}
Pr(TAXLIT_{i,t}) = {} & \alpha_0 + \alpha_1 TAX_{i,t-1} + \alpha_2 ROA_{i,t-1} + \alpha_3 SIZE_{i,t-1} + \alpha_4 LEV_{i,t-1} + \alpha_5 MTB_{i,t-1} \\
& + \alpha_6 RET_{i,t-1} + \alpha_7 RETVOL_{i,t-1} + \alpha_8 NOL_{i,t-1} + \alpha_9 \Delta NOL_{i,t-1} + \alpha_{10} SGA_{i,t-1} + \alpha_{11} RD_{i,t-1} \\
& + \alpha_{12} DACC_{i,t-1} + \alpha_{13} RESTATE_{i,t-1} + \alpha_{14} FI_{i,t-1} + \alpha_{15} CAPINT_{i,t-1} + \alpha_{16} INTANG_{i,t-1} \\
& + \alpha_{17} EQINC_{i,t-1} + \alpha_{18} M\&A_{i,t-1} + \alpha_{19} VEGA_{i,t-1} + \alpha_{20} DELTA_{i,t-1} + \alpha_{21} LITRISK_{i,t-1} \\
& + \alpha_{22} PCTIND_{i,t-1} + \alpha_{23} BOARDSIZE_{i,t-1} + \alpha_{24} GOVMISSING_{i,t-1} + Year\ FE \\
& + Industry\ FE + \varepsilon_{i,t}
\end{aligned} \tag{1}
$$

where subscripts *i* and *t* represent firm and year, respectively, *TAXLIT* is an indicator variable

equal to one for years in which shareholders file tax-related litigation against the firm, and zero

otherwise, and *TAX* represents *CETR*, *GETR*, *TAVOIDER*, *GAVOIDER*, and *UTB* as described

above. We measure our tax variables of interest and control variables at year *t*-1.

We control for several factors that prior research suggests are associated with firm

litigation risk, including return on assets (*ROA*), logged assets (*SIZE*), leverage (*LEV*), market to

book (*MTB*), capital intensity (*CAPINT*), research and development costs (*RD*), stock returns

(*RET*), and return volatility (*RETVOL*) (Cao and Narayanamoorthy 2014; Gillan and Panasian

2015; Kim and Skinner 2012). We control for discretionary accruals (*DACC*) and restatement

announcements (*RESTATE*) since poor financial reporting quality also increases litigation risk

(Cao and Narayanamoorthy 2014). We also include additional control variables associated with

tax avoidance that may also affect tax litigation risk, including the presence of foreign operations

(*FI*); net loss carryforwards (*NOL*); subsequent changes in NOLs (*ΔNOL*); selling, general, and

administrative expenses (*SGA*); and differences in financial and tax accounting treatment on a

firm's investment activities, such as equity income in earnings (*EQINC*) and intangible intensity

(*INTANG)* (Arena et al. 2021; Cao and Narayanamoorthy 2014; Lin et al. 2013).

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In addition, we control for merger and acquisition activity (*M&A*), as these transactions increase both overall litigation risk (Core 1997) and the risk of tax litigation more specifically (LaCroix 2014). We also include *DELTA* and *VEGA* to control for managerial risk-taking incentives that may affect tax avoidance and litigation risk (Lin et al. 2013; Rego and Wilson 2012). Prior research (e.g., Core 2000; Gillian and Panasian 2015) finds that a firm's corporate governance structure affects litigation risk, so we control for board independence (*PCTIND*) and board size (*BOARDSIZE*).[6] Finally, we control for ex ante securities litigation risk (*LITRISK*) (Kim and Skinner 2012). We include Fama-French 48 industry and year fixed effects and cluster standard errors by firm. All variables are defined in detail in Appendix B.

3.3.2. Sued firm research design (H2)

To examine the association between shareholder tax litigation and sued firm tax behavior, we focus on firms sued by their shareholders for any reason (i.e., for tax-related issues and non-tax issues). Thus, we identify treatment firms as those with shareholder tax litigation and control firms as those in the same industry with *non-tax* shareholder litigation. Importantly, this design holds shareholder litigation scrutiny constant, thereby isolating the *specific* effect of shareholder scrutiny of tax issues on firm tax behavior. We compare the tax avoidance behavior of treatment and control firms for the two years before and after the litigation date of interest (Donelson et al. 2021a). We focus on the class period end as our date of interest in this test because this date signifies the end of the period over which damages occurred and when the revelation of the misconduct and correction of stock price occurred (Armstrong et al. 2010).[7] We require at least four years between each firm's litigation to minimize overlap between pre- and post-periods. We

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[6] Given that data necessary to compute *BOARDSIZE*, *DELTA*, *PCTIND*, and *VEGA* is only available for a portion of our sample, we follow Cassell et al. (2013) and Hanlon et al. (2003) in setting missing values of these variables to zero and set an indicator variable to one that is zero otherwise (*GOV_MISSING*).

[7] See Figure 2 for a timeline of the various time periods involved in shareholder tax litigation.

then estimate the following difference-in-differences specification using weighted OLS or logistic regression, depending on the dependent variable of interest:

$$TAX_{i,t} = \alpha_0 + \alpha_1 TREAT_{i,t} + \alpha_2 POST_{i,t} + \alpha_3 TREAT * POST_{i,t} + \alpha_k CONTROLS_{i,t}$$
$$+ Year\ FE + Industry\ FE + \varepsilon_{i,t} \qquad (2)$$

where *TAX* and *CONTROLS* are as defined above. *TREAT* is an indicator variable equal to one for firms with shareholder tax litigation, and zero otherwise, and *POST* is an indicator variable equal to one for the two years on or after the class period end, and zero for the two preceding years. The coefficient on *TREAT * POST* represents the effect of shareholder tax litigation on sued firms' subsequent tax avoidance. To the extent that sued firms reduce tax avoidance after shareholder tax litigation as H2 predicts, we expect the coefficient on *TREAT * POST* to be positively (negatively) associated with *CETR* and *GETR* (*TAVOIDER*, *GAVOIDER*, and *UTB*).

Although our research design mitigates the extent to which differences in shareholder scrutiny between treatment and control firms influence our results, we use entropy balancing to ensure that treatment and control firms are similar on observable dimensions. Entropy balancing reweights observations so that treatment and control firms exhibit covariate balance jointly for the desired moment conditions (e.g., mean) across all variables (Hainmueller 2012). In contrast to other matching methods that can be sensitive to certain design choices (e.g., propensity score matching – see Shipman et al. 2017; Defond et al. 2016), entropy balancing minimizes design choices while maximizing our sample, which is important given the relatively low incidence of shareholder tax litigation in general. We entropy balance our sample using all variables in equation (2), supplemented with *GETR* at year *t*-1 following Kubick et al. (2016).[8] Importantly,

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[8] Results (untabulated) are similar for both H2 and H3 if we instead entropy balance our sample after supplementing all variables in equation (2) with 1) lagged values of *both GETR* and *CETR* or 2) the lagged tax measure for the dependent variable (e.g., when *CETR* is the dependent variable, we entropy balance our sample using all variables in equation (2) and lagged values of only *CETR*). However, in the latter case, we do not achieve covariate balance when the dependent variable in equation (2) is *UTB* as *UTB* data is only available for a small subset of our sample.

entropy balancing on prior period tax avoidance minimizes the risk that our results are due to
mean reversion, rather than changes in firm behavior resulting from shareholder tax litigation.

3.3.3. Spillover effects research design (H3)

To test whether the effects of shareholder tax litigation spillover to a sued firm's peers,
we first sort firms into terciles of litigation risk (*LITRISK*) by Fama-French 48 industry following
Donelson et al. (2021a). We retain any shareholder tax case where the sued firm is in the highest
tercile of *LITRISK* to focus on firms most likely to change their tax behavior due to increased
litigation risk since most firms face immaterial litigation risk (Nelson and Pritchard 2016). We
eliminate potential peer firms that have been sued in the past two years. This requirement ensures
that any detected effect for peer firms is due to the *sued* firm's shareholder tax litigation and not
to an unrelated concurrent litigation case for the peer firm itself (Rogers and Van Buskirk 2009).
We then select treatment firms by matching sued and peer firms in the same Fama-French 48
industry and in the highest tercile of litigation risk. In contrast, control firms are those in same
Fama-French 48 industry as the sued firm in the lowest tercile of litigation risk.

Thus, although treatment and control firms are subject to similar economic factors,
control firms should not respond to the increase in tax-related litigation risk as they face minimal
risk of being sued. We compare the tax avoidance behavior of treatment and control firms for
two years before and after the filing date of the sued firm's litigation (Donelson et al. 2021a).[9]
We then estimate the following difference-in-differences specification using weighted OLS or
logistic regression, depending on dependent variable of interest:

$$TAX_{i,t} = \alpha_0 + \alpha_1 TREATPEER_{i,t} + \alpha_2 POSTPEER_{i,t} + \alpha_3 TREATPEER * POSTPEER_{i,t}$$
$$+ \alpha_k CONTROLS_{i,t} + Year\ FE + Industry\ FE + \varepsilon_{i,t} \qquad (3)$$

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[9] We do not impose restrictions on the number of years between litigation cases given that retaining shareholder tax
litigation firms in the top tercile of litigation risk already substantially decreases the number of tax cases in this test
and because overlap in the pre- and post-periods is relatively minimal.

where *TAX* and *CONTROLS* are as defined above. *TREATPEER* is an indicator variable equal to one for peer firms of the sued firm in the highest tercile of litigation risk, and zero otherwise, and *POSTPEER* is an indicator variable equal to one for the two years on or after the filing date of the sued firm's litigation, and zero for the two preceding years (Donelson et al. 2021a). The coefficient on *TREATPEER * POSTPEER* represents the spillover effect of shareholder tax litigation on peer firms' subsequent tax avoidance. To the extent that peer firms reduce their tax avoidance after the sued firm's tax litigation as H3 predicts, we expect the coefficient on *TREATPEER * POSTPEER* to be positively (negatively) associated with *CETR* and *GETR* (*TAVOIDER*, *GAVOIDER*, and *UTB*), respectively. Similar to our tests for H2, we entropy balance our sample using all variables in equation (2), supplemented with *GETR* at year *t*-1 (Kubick et al. 2016). As we make directional predictions in H1 through H3, we use one-tailed tests for our variables of interest and two-tailed tests for other variables (Tables 3 through 9).[10]

4. Empirical results

4.1. Descriptive statistics

Table 3, Panel A presents descriptive statistics for all variables used to estimate equation (1) for tests of H1. Our sample includes 1,130 firm-year observations, corresponding to 34 shareholder tax litigation cases and 1,096 non-tax cases.[11] The average firm has a *GETR* of 0.267, *CETR* of 0.221, and *UTB* representing 1.7 percent of assets, similar to prior research (e.g., Lee et al. 2020; Lisowsky et al. 2013; McGuire et al. 2012). Descriptive statistics for other variables are similar to those in prior research. In Panel B of Table 3, we compare descriptive

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[10] Although O'Connell (2014) acknowledges that that firms can be sued for failing to undertake certain tax avoidance strategies, this appears to be extremely rare (Donelson et al.,2020). Thus, it is unlikely that firms are sued by their shareholders for not engaging in enough tax avoidance. In addition, we know of no reason why sued firms or their peers would engage in *greater* tax avoidance following shareholder litigation.

[11] The decreased number of cases relative to Table 1 is due to attrition primarily from requiring available data for control variables and excluding loss firms and those in financial or utility industries (Dyreng et al. 2008).

statistics for firms with shareholder tax litigation (*TAXLIT* = 1) to those with non-tax shareholder litigation (*TAXLIT* = 0). We find no significant differences for *GETR*, *CETR*, *GAVOIDER*, *TAVOIDER*, and *UTB* ($p > 0.10$). However, while the characteristics of firms with shareholder tax litigation and non-tax shareholder litigation are generally not statistically different, we note that, in some cases, economically significant differences exist. As a result, we use entropy balancing in our later tests as discussed to ensure that the firm characteristics are similar across both samples.

4.2. Determinants of shareholder tax litigation (H1)

Table 4 presents results of estimating equation (1) for each of our tax variables of interest. The area under the ROC is at least 0.77 across all specifications, implying that our logit models provide acceptable discriminatory power (Hosmer and Lemeshow 2000). We find a negative and significant coefficient on *GETR*$_{t-1}$ ($p < 0.05$), suggesting that lower GAAP ETRs are associated with a greater likelihood of future shareholder tax litigation. In terms of economic significance, our results suggest that a one percentage point decrease in *GETR*$_{t-1}$ is associated with a 4.4 percent increase in the likelihood of shareholder tax litigation, holding all independent variables constant at their mean values (untabulated). However, we fail to find evidence of an association between *CETR*$_{t-1}$ and future shareholder tax litigation ($p = 0.74$). Taken together, this evidence suggests that on average, shareholders focus on GAAP ETR, rather than cash ETR.[12]

We next examine the association between relatively extreme levels of tax avoidance and future shareholder tax litigation. In contrast to the mixed results above, the coefficients on both *GAVOIDER*$_{t-1}$ and *TAVOIDER*$_{t-1}$ are positive and significant ($p < 0.10$), suggesting that firms with

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[12] Results (untabulated) are similar if we compute *CETR* and *GETR* over three-years, rather than annually. However, in our tests for H2 and H3, we follow prior research (e.g., Chen et al. 2019a; Kubick et al. 2016) in measuring *CETR* and *GETR* annually, rather than over multiple years, to ensure that our measures do not contain components of both pre- and post-treatment years.

relatively low levels of both cash and GAAP ETRs have a higher likelihood of future tax litigation. Economically, the marginal effect of $GAVOIDER_{t-1}$ ($TAVOIDER_{t-1}$) on $TAXLIT$ is 1.6 (1.9) percentage points, which corresponds to a 53 (65) percent increase in the unconditional probability of shareholder tax litigation, respectively (untabulated). In addition, the coefficient on UTB_{t-1} is positive and significant ($p < 0.10$). This suggests that shareholders are more likely to sue firms for tax issues when they report higher UTB balances. Overall, this suggests that shareholders are more likely to scrutinize their firm's tax issues via tax-related litigation when the firm engages in greater GAAP-based tax avoidance, relatively extreme levels of cash and GAAP tax avoidance or greater tax uncertainty, consistent with H1.

4.3. The consequences of shareholder tax litigation on sued firm tax behavior (H2)

Table 5, Panel A presents the covariate balance for the entropy balanced sample in our tests of H2. This sample includes 111 treatment (tax litigation firm) observations and 939 control (non-tax litigation firm) observations, corresponding to 32 shareholder tax litigation cases and 269 non-tax litigation cases. We find no significant differences between treatment and control firms, so we achieve excellent covariate balance for all variables. Table 5, Panel B presents the results of estimating equation (2) for our tax measures of interest using entropy balancing. The coefficient on $TREAT * POST$ is positive and significant for both $GETR$ and $CETR$ ($p < 0.10$), suggesting firms subject to shareholder tax litigation increase their GAAP and cash ETRs by 6.8 and 4.3 percentage points, respectively, following the revelation of the tax litigation.[13]

We also find a negative and significant coefficient on $TREAT * POST$ for $TAVOIDER$

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[13] In comparison, Kubick et al. (2016) find firms increase their GAAP (cash) ETRs by 1.4 (1.5) percentage points after the resolution of a tax-related comment letter. While our results suggest a much larger effect of shareholder tax litigation, it is important to note that tax-related comment letters are fairly common (e.g., nearly 30 percent of Kubick et al.'s 2016 sample received a tax-related comment letter in their sample). In contrast, shareholder tax litigation occurs with much less frequency, so the relatively rare nature may result in a larger response.

and *GAVOIDER* ($p < 0.10$), implying that sued firms also have a lower likelihood of relatively extreme tax avoidance following shareholder tax litigation. However, we find no evidence that sued firms change their levels of tax uncertainty (*UTB*) following shareholder tax litigation ($p = 0.88$). Overall, the evidence supports H2 and suggests shareholder scrutiny over tax issues leads sued firms to decrease tax avoidance after revelation of tax issues subject to shareholder scrutiny.

4.4. Spillover effects of shareholder scrutiny (H3)

Table 6, Panel A presents the covariate balance for our entropy balanced sample in our tests of H3. Our sample includes 1,049 treatment firm observations (peers with high litigation risk) and 1,650 control firm observations (peers with low litigation risk), corresponding to 25 shareholder tax litigation cases. We achieve excellent covariate balance for all variables as we find no significant differences on control variables between treatment and control firms.

Table 6, Panel B presents the results of estimating equation (3) for each of our tax measures of interest using entropy balancing. Similar to results for H2, the coefficient on *TREATPEER * POSTPEER* is positive and significant for *CETR* and *GETR* ($p < 0.05$) and negative and significant for *GAVOIDER* and *TAVOIDER* ($p < 0.10$). Results suggest treatment firms increase their GAAP and cash ETRs by 6.2 and 6.5 percentage points, respectively, after the sued firm's shareholder tax litigation. Similarly, we find that the marginal effect of *TREATPEER * POSTPEER* on *GAVOIDER* and *TAVOIDER* is -21.5 (-13.0) percentage points, respectively, which corresponds to a 50 (35.7) percent decrease in the unconditional probability of relatively extreme cash and GAAP ETRs (untabulated).[14] In addition, the coefficient on

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[14] To ensure that firms in each of our tests have similar incentives to avoid taxes, we require firms have non-negative pretax book income and non-missing total tax expense and cash taxes paid in the litigation year of interest (i.e., the filing year for H1 and H3 and the year of the class period end date for H2) (Dyreng et al. 2008). Because this restriction considerably reduces the number of shareholder tax litigation cases in our sample, we re-estimate each of our tests without imposing this restriction and using cash and GAAP ETRs computed following Henry and Sansing (2018). With the exception of *GETR* for H1 and *TAVOIDER* for H3, results are similar to those reported above (untabulated). However, these differences may be driven by power issues as De Simone et al. (2020) find the Henry

*TREATPEER * POSTPEER* is negative and significant for *UTB* ($p < 0.05$), which suggests that treatment firms decrease the uncertainty component of tax avoidance after their peer's tax litigation. Overall, the results indicate that the effects of shareholder scrutiny on firm tax behavior are not solely limited to sued firms, but also include their peers, consistent with H3.

5. Additional analyses

Although several studies examine direct effects of scrutiny on tax behavior (e.g., Chen et al. 2019b; Dyreng et al. 2016; Hoopes et al. 2012; Kubick et al. 2016), we have relatively limited knowledge about the potential spillover effects of scrutiny. Results from our spillover analyses suggest sued firms' peers engage in less tax avoidance after shareholder tax litigation. To provide further insight into the reach of shareholder litigation, we conduct cross-sectional analyses to examine whether these spillover effects vary based on the visibility of the sued firm and the likelihood that peer firms engaged in similar tax activities that triggered the litigation.

5.1. Product market power and spillover effects of shareholder tax litigation

We first investigate whether the sued firm's product market power affects how their peers respond to the sued firm's shareholder tax litigation. Peer firms mimic the tax behavior of product market leaders to maintain competitive positions within their industries (Kubick et al. 2015). Thus, peers of product market leader-sued firms may decrease their tax avoidance to a greater degree after the sued firm's shareholder tax litigation, relative to less powerful, sued firms. To test this possibility, we compute product market power using the industry-adjusted price-cost margin (PCM) (Peress, 2010). Following Kubick et al. (2015), we classify sued tax litigation firms as product market leaders (*PML*) if their PCM is in the highest tercile of the distribution in the industry-filing year and zero otherwise and interact this variable with each of

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and Sansing (2018) tax measures have lower power relative to other tax avoidance proxies.

our *TREATPEER* and *POSTPEER* variables. We then estimate the following regression:

$$
\begin{aligned}
TAX_{i,t} = {} & \alpha_0 + \alpha_1 TREATPEER_{i,t} + \alpha_2 POSTPEER_{i,t} + \alpha_3 TREATPEER * POSTPEER_{i,t} \\
& + \alpha_4 PML_{i,t} + \alpha_5 PML * TREATPEER_{i,t} + \alpha_6 PML * POSTPEER_{i,t} \\
& + \alpha_7 PML * TREATPEER * POSTPEER_{i,t} + \alpha_k CONTROLS_{i,t} + Year\ FE \\
& + Industry\ FE + \varepsilon_{i,t} \quad\quad\quad\quad\quad\quad\quad\quad\quad\quad\quad\quad\quad (4)
\end{aligned}
$$

where all variables are defined as above and the coefficient on *PML * TREATPEER **

POSTPEER represents the incremental effect of sued firms' product market power on the

relation between shareholder tax litigation and peer firm tax avoidance.[15]

Table 7 presents the results. Beginning with results for treatment firms where the sued

firm is not a product market leader, the coefficient on *TREATPEER * POSTPEER* is

insignificant across all of our proxies for tax avoidance ($p \geq 0.32$). Thus, shareholder litigation

has little effect on peers' tax avoidance behavior when the sued firm has limited product market

power. In contrast, the coefficient on *PML * TREATPEER * POSTPEER* is positive (negative)

and significant for *GETR* and *CETR* (*GAVOIDER* and *TAVOIDER*) ($p < 0.05$), implying that

when the sued firm is a product market leader, industry peer firms increase their cash and GAAP

ETRs and decrease their likelihood of extreme cash and GAAP tax avoidance after the tax

litigation. However, we do not find a significant coefficient on *PML * TREATPEER **

POSTPEER when *UTB* serves as our proxy for tax avoidance ($p > 0.10$). Overall, this suggests

that the sued firm's product market power increases the extent to which their peers reduce their

tax avoidance following the sued firm's shareholder tax litigation, likely because such peers may

have mimicked the underlying behavior that resulted in litigation (see Kubick et al. 2016).

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[15] Consistent with our primary tests, we entropy balance both cross-sectional analyses to ensure treatment and control firms are similar on observable dimensions. Given the relatively small amount of shareholder tax litigation cases in these tests, we set the tolerance criteria (i.e., the maximum deviation from the moment conditions) to its maximum value to best facilitate entropy balancing in these tests (Hainmueller 2012). However, results (untabulated) are similar if we set the tolerance to its default value (0.015), consistent with our main tests.

5.2. Media coverage and spillover effects of shareholder tax litigation

We next investigate whether high media coverage of the sued firm affects the relation between peer tax avoidance and sued firm shareholder tax litigation. Media coverage influences how firms are perceived and focuses the attention of external stakeholders on the individual firm's behavior (Bednar et al. 2013). Because tax planning strategies are often similar across firms in the same industry (Kubick et al. 2015), peer firms may fear similar litigation when the sued firm receives significant media coverage around the litigation as it makes it more likely that investors in those peer firms would be scrutinizing for similar potential misconduct. Hence, peer firms may be more likely to reduce their tax avoidance behavior following shareholder tax litigation when the sued firm is subject to high media attention.

To test this, we follow Donelson et al. (2021c) and count the number of media articles on Factiva for the three-day periods before and after the filing date of the sued firm's shareholder tax litigation, excluding press wires. We compute abnormal media coverage by comparing the number of articles around the filing date with those for the same period one year earlier and express this as a percent change. Thus, it captures news coverage that is unexpected given the firm's normal operating environment. We create an indicator variable (*HIMEDIA*) equal to one if the sued firm's abnormal media coverage around the filing date is in the highest tercile of the distribution of abnormal media coverage for all shareholder tax litigation cases in that year, and zero otherwise.[16, 17] We interact *HIMEDIA* with each of our *TREATPEER* and *POSTPEER* variables and estimate the following regression:

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[16] The mean (median) percent change in abnormal media coverage for firms where *HIMEDIA*=1 is 435 (416) percent, respectively (untabulated), suggesting that firms in this subsample experience economically significant changes in media coverage.

[17] To ensure that firms used to rank abnormal media coverage have similar incentives to avoid taxes, we eliminate any shareholder tax litigation cases for firms in the financial and utility industries and those with negative or missing pre-tax income and missing total tax expense and cash taxes paid.

$$TAX_{i,t} = \alpha_0 + \alpha_1 TREATPEER_{i,t} + \alpha_2 POSTPEER_{i,t} + \alpha_3 TREATPEER * POSTPEER_{i,t}$$
$$+ \alpha_4 HIMEDIA_{i,t} + \alpha_5 HIMEDIA * TREATPEER_{i,t} + \alpha_6 HIMEDIA * POSTPEER_{i,t}$$
$$+ \alpha_7 HIMEDIA * TREATPEER * POSTPEER_{i,t} + \alpha_k CONTROLS_{i,t} + Year\ FE$$
$$+ Industry\ FE + \varepsilon_{i,t} \qquad\qquad (5)$$

Table 8 presents the results. The coefficient on *TREATPEER * POSTPEER* is insignificant when *GETR*, *CETR*, *GAVOIDER*, and *TAVOIDER* serve as our proxies for tax avoidance ($p > 0.10$), but significant when we examine *UTB* ($p < 0.10$). These findings are consistent with shareholder litigation having little effect on peers' tax avoidance behavior when the sued firm receives little or no media coverage, although the results for *UTB* may indicate a general industry increase in tax uncertainty from the tax litigation. Consistent with our expectations, the coefficient on *HIMEDIA * TREATPEER * POSTPEER* is positive (negative) and significant for *GETR* and *CETR* (*GAVOIDER* and *TAVOIDER*), respectively ($p < 0.10$). This result suggests that when sued firms are highly covered in the media, treatment firms increase their cash and GAAP ETRs and decrease their likelihood of extreme cash and GAAP tax avoidance following tax litigation. However, we find do not find a significant interaction coefficient when *UTB* serves as our proxy for tax avoidance ($p > 0.10$), likely because the reduction in such firms' tax avoidance has negated the industry-wide increase in tax uncertainty. Collectively, the evidence is consistent with peer firms decreasing their tax avoidance when the sued firm is highly covered in the media and, thus, highly visible.

5.3. Parallel trends assumption

A critical assumption in difference-in-differences estimation is that treatment and control firms exhibit similar trends in the pre-treatment period (i.e., parallel trends assumption) (Roberts and Whited, 2013). In this section, we conduct two analyses to assess the validity of this assumption for our tests of H2 and H3. First, we follow Kubick et al. (2016) in comparing growth rates between treatment and control firms for each of our tax avoidance proxies in the

pre-period. To the extent that growth rates for our tax variables are statistically indistinguishable in the pre-period, this is consistent with both treatment and control firms following similar trends in the pre-treatment period. Table 9 presents results of *t*-tests of differences in growth rates for *GETR*, *CETR*, and *UTB*.[18] Beginning with results for H2 (Panel A), we find no significant difference in growth rates between treatment and control firms for *GETR*, *CETR*, and *UTB* ($p > 0.10$).[19] As Panel B shows, growth rates for each measure are also statistically indistinguishable between treatment and control firms in the pre-period for H3 ($p > 0.10$) Overall, this evidence is consistent with the parallel trends assumption being met for H2 and H3.

To provide further evidence consistent with the parallel trends assumption, we conduct falsification tests for H2 and H3 using pseudo-filing and class period end dates set three years before each respective date (Jiang et al. 2019). To the extent that shareholder tax litigation, rather than an unknown past event, motivates both sued firms and their peers to decrease their tax avoidance, we expect the coefficient on *TREAT * POST* and *TREATPEER * POSTPEER* to be insignificant (Roberts and Whited 2013). Beginning with tests of H2 in Panel A of Table 10, the coefficient on *TREAT * POST* is insignificant across all of our proxies for tax avoidance ($p > 0.56$), implying that the effect of shareholder tax litigation on sued firm tax behavior is not attributable to unrelated events occurring in prior periods. Panel B of Table 9 presents results for tests of H3. With one exception, the coefficient on *TREAT * POST* is insignificant across all proxies for tax avoidance ($p \geq 0.40$), suggesting that the effect of shareholder tax litigation on peers' tax avoidance behavior occurs in the litigation filing year and not in previous periods.

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[18] We do not present results of t-tests of differences of *GAVOIDER* and *TAVOIDER* because the binary nature of these variables does not provide meaningful growth rates when the lagged value of either measure is zero (i.e., division by zero is undefined). The sample size for these tests also varies from those in our primary tests due to lagged values of some observations for *CETR* and *GETR* being zero.

[19] We use two-tailed tests in these tests because we are agnostic to the direction of the difference in growth rates.

However, the coefficient on *TREAT * POST* is significant for *CETR* ($p < 0.10$), although

statistical significance is vastly reduced relative to our primary results. Given that nine of ten

measures are insignificant, the evidence is largely consistent with the parallel trends assumption.

5.4. Shareholder tax litigation triggered by IRS audits or regulatory litigation

As noted, while rare, tax authority audits and regulatory litigation sometimes trigger

shareholder tax litigation. Although the overlap is minimal and our primary tests exclude cases

filed after regulatory litigation, we conduct several additional tests to ensure that our results are

attributable to shareholder tax litigation. Specifically, we re-estimate our tests after separately

excluding shareholder tax litigation 1) triggered by an IRS, state or foreign tax authority audit, 2)

triggered by SEC or other federal, state or foreign government litigation, or 3) followed by

regulatory enforcement or litigation. Untabulated results are similar to those reported earlier with

two exceptions. Specifically, *CETR* in H2 and *TAXAVOIDER* in H3 are marginally insignificant

($p > 0.10$) after excluding tax cases triggered by regulatory litigation. However, these differences

are likely due to lower power in these tests, given that exclusion of these cases reduces the

number of tax litigation cases over 52 percent. Nonetheless, the evidence suggests that our

results capture the effects of shareholder tax litigation, rather than other types of litigation.

5.5. Tax-related SEC comment letters

In this section, we conduct additional analysis to ensure that our results are not driven by

tax-related comment letters since Kubick et al. (2016) find that SEC comment letters negatively

affect both firm and peer tax avoidance. Specifically, we re-estimate our tests after including an

indicator variable set equal to one if a firm receives a tax-related comment letter in that year, and

zero otherwise.[20] We begin our sample in 2005 because this is the first full year of publicly

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[20] We follow Kubick et al. (2016) in identifying tax-related comment letters as those citing either tax topics (using the taxonomy provided by Audit Analytics) or issues involving any variation of the following words: "Tax," "FAS

available comment letter correspondence in Audit Analytics. Results are similar to those reported

in the paper with the exception of *CETR* in H2, which is marginally insignificant ($p = 0.12$)

(untabulated). However, given that the coefficient on *CETR* is also insignificant without

controlling for tax-related comment letters and that the exclusion of pre-2005 firm-years reduces

the sample size in these tests by over 38 percent, this difference is likely due to power issues.

6. Conclusion

We examine the effect of shareholder scrutiny of tax issues on corporate tax behavior,

including both explicit taxes and tax reporting and disclosure, *through* tax-related litigation. We

first find that firms that engage in greater tax reporting aggressiveness and relatively extreme

cash or GAAP tax avoidance are more likely to face shareholder litigation. We then find that

sued firms increase their cash and GAAP ETRs and have a lower likelihood of extreme cash and

GAAP tax avoidance after shareholder tax litigation. Finally, high-litigation risk industry peers

to sued firms also increase their cash and GAAP ETRs and decrease their UTBs and likelihood

of extreme cash and GAAP tax avoidance after the litigation. Results for these spillover tests are

strongest where theory would predict—spillover is greater when sued firms are product market

leaders and receive abnormal media coverage around the litigation.

Collectively, our results show that tax-related litigation is an important mechanism by

which *shareholders* can both penalize firms that have engaged in potentially adverse tax

behaviors and serve as a broader disincentive to industry peers. Given resource constraints at the

IRS and SEC (e.g., Ege et al. 2020; Nessa et al. 2020), the fact that shareholder scrutiny can

result in changes to corporate tax behavior demonstrates that this private enforcement serves as

an important and growing complement to more traditional (and researched) public enforcement.

109," "SFAS 109," "FIN 48," and "ASC 740."

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Appendix A. Shareholder tax litigation case examples

This appendix provides examples of, and excerpts from, derivative and securities class action shareholder tax litigation related to explicit taxes, tax financial reporting, and other issues.

A.1 Explicit tax related issues

A.1.1 Silver Wheaton Corporation[21]

In securities class action litigation filed in 2015 against Silver Wheaton Corporation and certain of its officers and directors, a group of shareholders alleged that the firm violated federal securities laws by issuing several materially false and misleading statements. According to the complaint, between 2005 and 2010, Silver Wheaton used a subsidiary in the Cayman Islands to underreport its taxable income to the Canada Revenue Agency (CRA). Shareholders allege that Silver Wheaton and its officers and directors knew the Cayman Island tax positions were indefensible and likely to result in future tax assessments, penalties, and interest, but did not disclose this in the financial statements. In July of 2015, Silver Wheaton issued a press release indicating that the CRA had determined that the firm's taxable income should be increased by approximately $567 million for the period 2005-2010, resulting in additional taxes and penalties due in excess of $207 million. In response to this announcement, the firm's stock declined approximately 12 percent. The case was settled in early 2020 for $41.5 million.

A.1.2 Tommy Hilfiger Corporation[22]

In 2004, a shareholder of Tommy Hilfiger Corporation filed a securities class action lawsuit individually and on behalf of others against the firm and its officers and directors for knowingly manipulating its financial statements by engaging in a profit shifting scheme. Specifically, the claim alleges that the firm shifted profits by paying buying-agency commissions to its subsidiaries in lower tax jurisdictions and reporting revenue generated in the U.S. as if it were earned in lower-tax foreign divisions. As a result, Tommy Hilfiger Corporation's tax rate was artificially lower, which inflated the firm's revenue and income in violation of GAAP. Shortly before shareholders filed this litigation, Tommy Hilfiger Corporation announced that one of its subsidiaries, Tommy Hilfiger U.S.A., Inc. (THUSA) was being investigated by the U.S. Attorney's Office for the Southern District of New York over commissions paid by THUSA to a foreign subsidiary of the firm. The firm's stock declined approximately 22 percent in response to this news. The case was settled in 2008 for $16 million.

A.2 Tax financial reporting

A.2.1 Ormat Technologies, Inc.[23]

In 2018, a shareholder of Ormat Technologies, Inc. (Ormat) filed a securities class action lawsuit individually and on behalf of others against the firm and its CEO and CFO for violations of

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[21] See https://securities.stanford.edu/filings-case.html?id=105631.
[22] See https://securities.stanford.edu/filings-case.html?id=103247.
[23] See https://securities.stanford.edu/filings-case.html?id=106637.

federal securities laws arising from accounting for income tax issues. According to the complaint, the firm made false or misleading statements and/or failed to disclose that: 1) its income tax provision was incorrect because Ormat released its valuation allowance despite evidence that the underlying deferred tax asset could not be utilized; 2) it netted certain deferred tax assets and deferred tax liabilities across different tax jurisdictions, in violation of GAAP; and 3) it had identified a material weakness in its internal controls over financial reporting for income taxes. As a result of these issues, Ormat's 2017 Form 10-K and Form 10-Q for the second, third, and fourth quarters of 2017 were materially false and would have to be restated. After Ormat announced it would not be able to timely file its Form 10-Q for the first quarter of 2018 due to the accounting for income tax issues, the firm's stock fell over 6 percent. The case settled for $3.8 million in January of 2021.

A.2.2 Scottish Re Group[24]

In 2006, shareholders, including lead plaintiffs Richard Allen Baehr and the State Teachers Retirement System of Ohio, filed a consolidated securities class action lawsuit against Scottish Re Group for violations of federal securities laws arising from accounting for income tax issues. According to the complaint, "…the Company ' s violations of GAAP arose out of its failure, at all relevant times during the Class Period, to properly account for deferred tax assets. During the Class Period and at the time of the Offerings, the Company reported material deferred tax assets notwithstanding the fact that long-planned securitization transactions (critical for Scottish Re to raise required insurance reserves) rendered the ability of the Company to benefit from those assets unlikely. Scottish Re failed to account for its securitization plans as required by GAAP until the end of the Class Period, when it suddenly announced a large tax valuation allowance which, inter alia, triggered reductions in the Company's credit ratings and threatened its ability to continue as a going concern." Following the announcement of Scottish Re's recognition of a valuation allowance, the firm's stock price decreased approximately 75% in one trading day. The case was settled in 2008 for $38 million.

A.3 Both explicit tax related and tax financial reporting

A.3.1 Maxim Integrated Products, Inc.[25]

In 2006, a shareholder of Maxim Integrated Products, Inc. (Maxim) filed derivative litigation alleging that certain of the firm's officers and directors breached their duties of due care and loyalty by approving or accepting backdated stock options. The complaint was prompted by a May 2006 report issued by Merrill Lynch which showed that officers of Maxim and other companies were remarkably effective at timing options pricing events, suggesting that stock option backdating may have occurred at these firms. The complaint alleges that between 1998 and 2002, the firm violated the terms of its shareholder-approved executive compensation plans and knowingly mislead shareholders by backdating nine stock option grants to its CEO, John Gifford. In doing so, Maxim improperly took tax deductions on the stock options and overstated

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[24] See https://securities.stanford.edu/filings-case.html?id=103650.
[25] See https://caselaw.findlaw.com/de-court-of-chancery/1032258.html.

its net income, which necessitated restatements to the firm's financial statements and tax filings and exposing it to adverse tax consequences. The case settled in 2009 for $28.5 million.

A.4 Other

A.4.1 AbbVie, Inc.[26]

In 2014, Shire PLC's (Shire) shareholders filed a securities class action individually and on behalf of others against AbbVie, Inc. (AbbVie) and its CEO for violations of federal securities laws. According to the complaint, in July of 2014, Shire and AbbVie entered into an agreement through which AbbVie agreed to acquire Shire in a tax inversion transaction. As part of the agreement, AbbVie would relocate its headquarters abroad and become a foreign corporation to reduce its taxes. However, in September of 2014, the U.S. Treasury Department announced that it was issuing new rules eliminating most of the tax savings from these transactions. Following this announcement, AbbVie's CEO, Richard Gonzalez, issued a public letter to Shire's employees, "…stating that he was more energized than ever and more confident than ever about the Combination." The complaint contends that Gonzalez's letter was materially false and misleading because "The market and media regarded Gonzalez's statement as a sign that the Combination was moving forward despite changes announced in the Treasury Notice." In October of 2014, AbbVie announced that in response to the Treasury Notice, it was reconsidering the transaction. AbbVie's stock dropped in response to this announcement. Approximately a week later, AbbVie announced that it would pay Shire $1.64 billion to terminate the proposed transaction. The case settled in 2020 for $16.8 million.

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[26] See https://securities.stanford.edu/filings-case.html?id=105309.

Appendix B. Variable definitions

Variable	Definition
BOARDSIZE	The total number of directors on the board of directors. If a firm is missing this data, we set it equal to zero and set *GOV_MISSING* equal to one.
CAPINT	Capital intensity, measured as net property plant and equipment (PPENT), divided by lagged total assets (AT).
CETR	Cash ETR, computed as the sum of cash taxes paid (TXPD) for year t, divided by pre-tax income (PI) less special items (SPI).
DACC	Absolute value of discretionary accruals calculated following the modified-Jones discretionary accruals model (Dechow et al., 1995).
DELTA	Dollar change of the CEO's portfolio value for a one percent change in firm stock price (in thousands). If a firm is missing this data, we set it equal to zero and set *GOV_MISSING* equal to one.
EQINC	Equity income in earnings (ESUB), divided by lagged total assets (AT).
FI	Foreign income (PIFO), divided by lagged total assets (AT).
GAVOIDER	An indicator variable set to one if the firm's *GETR* is in the lowest tercile of the distribution, and zero otherwise.
GETR	GAAP ETR, computed as the sum of tax expense (TXT) for year t, divided by pre-tax income (PI) less special items (SPI).
GOV_MISSING	Separate indicator variables equal to one if any of the following variables are missing: *BOARDSIZE*, *DELTA*, *PCTIND*, and *VEGA*, and zero otherwise.
HIMEDIA	An indicator variable equal to one if the sued firm's percentage change in abnormal media coverage around the litigation filing date is in the highest tercile of the distribution of abnormal media coverage for all shareholder tax litigation cases in that year, and zero otherwise. We require that shareholder tax litigation cases correspond to firms in non-financial and non-utility industries with non-negative or non-missing pre-tax income and non-missing total tax expense and cash taxes paid. Abnormal media coverage is computed as the number of media articles for the sued firm on Factiva for the three days following and three days prior to the filing date less the media coverage for the same period one year earlier.
INTANG	Intangible assets (INTAN), divided by lagged total assets (AT).
LEV	Long-term debt (DLTT), divided by lagged total assets (AT).
LITRISK	Litigation risk, calculated using coefficients in model 3 of Table 7 of Kim and Skinner (2012).
M&A	An indicator variable equal to one if the firm has non-zero acquisitions or mergers (AQP) in a given year, and zero otherwise.
MTB	Market-to-book ratio at the beginning of the year, defined as market value of equity (CSHO * PRCC_F), divided by book value of equity (CEQ).
NOL	An indicator variable set equal to one if a firm has a positive loss carry forward (TLCF) at the beginning of the year, and zero otherwise.
ΔNOL	The change in the loss carry forward (TLCF), divided by lagged total assets (AT).
PCTIND	Percentage of independent directors on the board of directors. If a firm is missing this data, we set it equal to zero and set *GOV_MISSING* equal to one.
PML	An indicator variable equal to one if the sued firm's excess price-cost margin is in the highest tercile of the distribution for the industry-filing year, and zero otherwise. Following Peress (2010), we compute excess price-cost margin as operating profit (SALE-COGS-XSGA) over sales (SALE) of each firm less the value-weighted (based on sales) industry average (based on Fama-French 48 industry groupings). If COGS or XSGA are missing, we define operating profit as operating income after depreciation (OIADP).

POST	An indicator variable equal to one for the two-years following the sued firm's shareholder tax litigation, and equal to zero for the two years preceding this litigation. The date of each sued firm's shareholder tax litigation case is based on the end of the class period.
POSTPEER	An indicator variable equal to one for the two-years following the sued firm's shareholder tax litigation, and equal to zero for the two years preceding this litigation. The date of the sued firm's shareholder tax litigation is based on the filing date of the litigation.
RD	Research and development expenses (XRD), divided by lagged total assets (AT).
RESTATE	An indicator variable equal to one if the firm announces a restatement via a Form 8-K Item 4.02 non-reliance restatement or in a correction in the next required filing in accordance with SAB Topic 108, and zero otherwise.
RET	The excess of the buy-and-hold stock return for the fiscal year over the market return for the same period.
RETVOL	The standard deviation of the firm's monthly returns over the 12-month period ending with the firm's fiscal year end.
ROA	Return on assets, defined as pretax income (PI), divided by lagged total assets (AT).
SGA	Selling, general and administrative expenses (XSGA), divided by lagged total assets (AT).
SIZE	The natural logarithm of assets in millions (AT) at the end of the fiscal year.
TAX	Measures of tax avoidance used in our analyses, including *GETR, CETR, GAVOIDER, TAVOIDER*, and *UTB*.
TAVOIDER	An indicator variable set to one if the firm's *CETR* is in the lowest tercile of the distribution, and zero otherwise.
TAXLIT	An indicator variable set equal to one if the firm has tax-related securities class actions or derivative litigation filed in that year, and zero if the firm has non-tax related litigation in that year.
TREAT	An indicator variable set to one if the firm is a treatment firm, and zero if the firm is a control firm. Treatment firms are firms with shareholder tax litigation and control firms are those with non-tax shareholder litigation.
TREATPEER	An indicator variable set to one if the firm is a treatment firm, and zero if the firm is a control firm. Treatment firms are peer firms of the sued firm in the highest tercile of litigation risk and control firms are peer firms of the sued firm in the lowest tercile of litigation risk. Peer firms are those in the same Fama-French 48 industry as the sued firm.
UTB	Unrecognized tax benefits, measured as TXTUBEND at the end of the year, divided by lagged total assets (AT).
VEGA	Dollar change of the CEO's portfolio value for a one percent change in return volatility (in thousands). If a firm is missing this data, we set it equal to zero and set *GOV_MISSING* equal to one.

Figure 1
Trends in Shareholder Tax Litigation Over Time
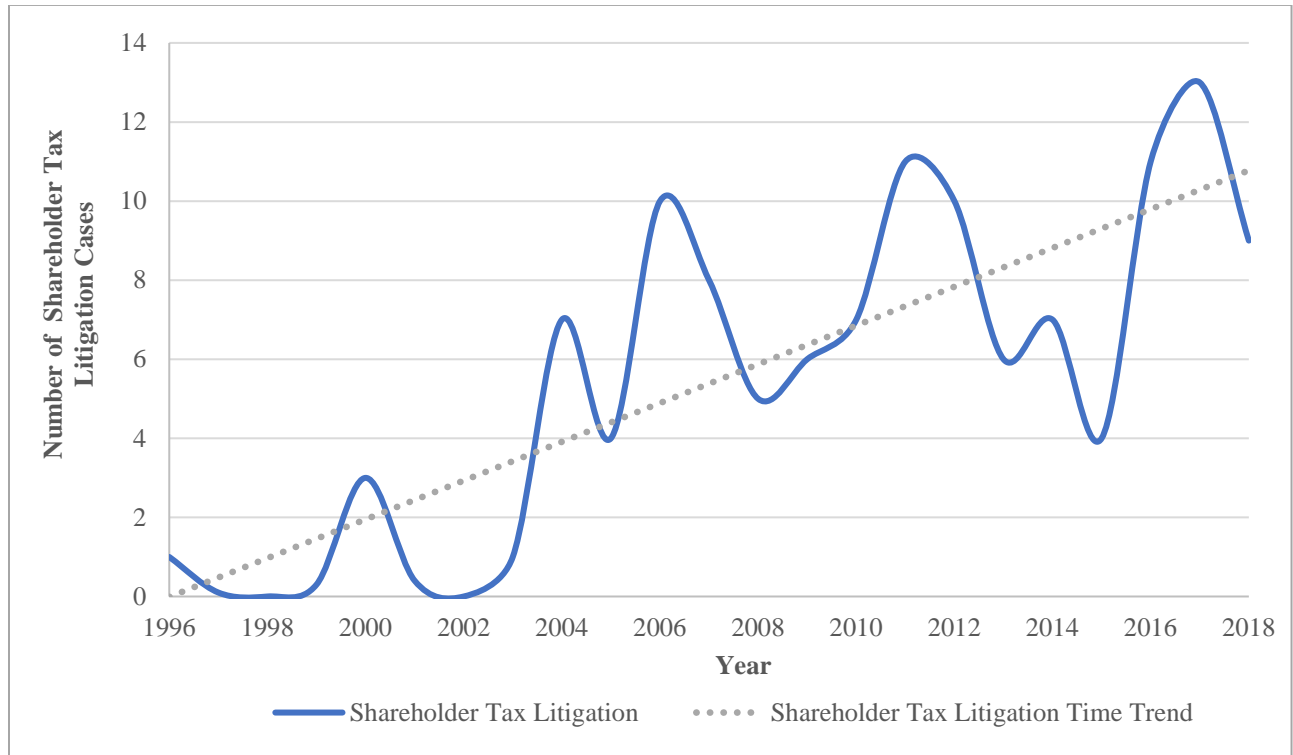
This figure depicts the trend in shareholder tax litigation over our sample period.

Figure 2
Shareholder Tax Litigation Timeline
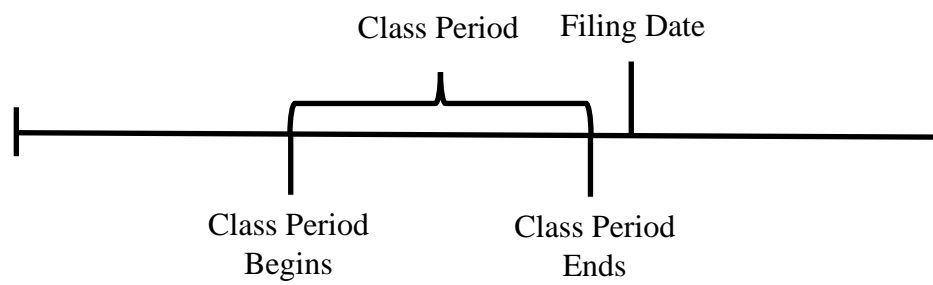
The figure illustrates the typical timeline of the various time periods involved in shareholder tax litigation. As the duration of the class period and amount of time between the class period end date and filing date can vary, the time periods are not drawn to scale.

Table 1
Shareholder Tax Litigation Descriptive Information

Panel A: Frequency of Shareholder Tax Litigation over Sample Period	
Item	Amount
Total cases	123
Cases per year	5.3
Pending/stayed cases	21
Dismissed cases	45
Settled cases	57
Settlements	$949.6
Mean settlement	$17.6
Median settlement	$2.6

Panel B: Frequency of Cases by Type of Shareholder Tax Litigation				
Category	# of Cases	% of Total Cases	Mean Settlement	Median Settlement
Derivative	56	46%	$10.4	$0.8
Securities Class Action	67	54%	$23.6	$12.5
Total	128	100%	$17.6	$2.6

Panel C: Frequency of Cases by Tax Activity				
Category	# of Cases	% of Total Cases	Mean Settlement	Median Settlement
Explicit tax focused	63	51%	$14.7	$3.8
Tax financial reporting focused	39	32%	$27.1	$2.7
Both	14	14%	$7.2	$1.6
Other	7	7%	$0	$0
Total	123	100%	$17.6	$2.6

This table presents descriptive information about the types of shareholder tax litigation in our sample period from 1996-2018. Panel A provides the number, outcome, and settlements for shareholder tax litigation, and Panel B provides information about the types of litigation included in our sample. Panel C provides information on the nature of the tax activity targeted in the litigation. Mean and median settlement amounts are computed using settled cases for each category and reported in millions.

Table 2
Shareholder Tax Litigation Details

Panel A: Types of Tax Activities Underlying Shareholder Tax Litigation

Tax Activity	# of Cases	% of Total Cases
Accounting for income tax (Deferred Taxes/Tax Provision)	38	31%
Deductibility of executive compensation	19	15%
Income shifting through foreign subsidiaries	9	7%
Shareholder tax implications of tax inversion	7	6%
Tax deductions for backdated options	7	6%
Underpaid payroll taxes	7	6%
Overly risky tax strategies (illegal tax shelters/excessive use of federal and state tax-credit investments)	5	4%
Underpaid/undercollected/delinquent in paying federal, state, or local income taxes	5	4%
Bribes paid to lower foreign tax liability or secure foreign tax refunds	4	3%
Fraudulently obtained tax credits or charitable contribution deduction	4	3%
Change in state, federal, or foreign tax rules	3	2%
Overpaid state sales or income tax	3	2%
Taxation of deemed dividends	3	2%
Realizability of or eligibility for NOL carryback/carryforward	2	2%
Firm acted as intermediary in Tenant-in-Common tax shelter investments	2	2%
Taxation of sale of ownership interest	2	2%
Executives plotted to avoid foreign tax fine	1	1%
Failure to properly compute losses for tax purposes	1	1%
Incorrectly calculated tax basis of foreign subsidiaries and amortization of intangible assets	1	1%
Tax evasion (federal or foreign taxes)	1	1%
Taxation of insurance premiums	1	1%

Panel B: Events Triggering the Filing of Tax-Related Litigation

Event	# of Cases	% of Total Cases
Restatement announcement	30	24%
Firm announcement/disclosure about financial condition, error, or wrongdoing (no restatement announced)	22	18%
Shareholder challenge to deductibility of executive compensation	19	15%
Media or analyst report accusing firm of accounting or tax irregularities or errors	8	7%
Option backdating scandal	7	6%
Shareholder issues with merger announcements or agreements	7	6%
Foreign government investigation	6	5%
IRS audit	6	5%
SEC, DOJ, or other federal or state investigation	5	4%
State tax authority audit	4	3%
Foreign tax authority audit	3	2%
Error admitted during a firm conference call	2	2%
Going concern opinion issued by auditor	1	1%
Trust beneficiary challenge on payment of state taxes	1	1%
Whistleblower or terminated employee	1	1%
Bankruptcy filing	1	1%
Total	123	100%

This table presents descriptive information about underlying tax activities (Panel A) and events that trigger shareholder tax litigation (Panel B) from 1996-2018. The tax activities listed in Panel A are not mutually exclusive.

Table 3
Descriptive Statistics

Panel A: Descriptive Statistics for H1 Sample						
Variable	N	Mean	Std. Dev.	p25	p50	p75
TAXLIT	1,130	0.030	0.171	0.000	0.000	0.000
GETR$_{t-1}$	1,130	0.267	0.194	0.144	0.275	0.360
CETR$_{t-1}$	1,116	0.221	0.197	0.078	0.191	0.315
GAVOIDER$_{t-1}$	1,130	0.429	0.495	0.000	0.000	1.000
TAVOIDER$_{t-1}$	1,116	0.364	0.481	0.000	0.000	1.000
UTB$_{t-1}$	521	0.017	0.021	0.004	0.011	0.022
ROA$_{t-1}$	1,130	0.118	0.141	0.038	0.100	0.179
SIZE$_{t-1}$	1,130	7.886	2.034	6.424	7.795	9.393
LEV$_{t-1}$	1,130	0.209	0.256	0.003	0.147	0.298
MTB$_{t-1}$	1,130	3.700	10.540	1.801	2.917	4.883
RET$_{t-1}$	1,130	0.139	0.913	-0.221	-0.010	0.272
RETVOL$_{t-1}$	1,130	0.123	0.073	0.075	0.105	0.151
NOL$_{t-1}$	1,130	0.496	0.500	0.000	0.000	1.000
ΔNOL$_{t-1}$	1,130	0.005	0.205	0.000	0.000	0.002
SGA$_{t-1}$	1,130	0.320	0.310	0.131	0.254	0.410
RD$_{t-1}$	1,130	0.054	0.078	0.000	0.021	0.087
DACC$_{t-1}$	1,130	0.079	0.105	0.022	0.047	0.094
RESTATE$_{t-1}$	1,130	0.193	0.395	0.000	0.000	0.000
FI$_{t-1}$	1,130	0.030	0.045	0.000	0.008	0.058
CAPINT$_{t-1}$	1,130	0.255	0.224	0.094	0.188	0.348
INTANG$_{t-1}$	1,130	0.248	0.282	0.027	0.166	0.381
EQINC$_{t-1}$	1,130	0.001	0.004	0.000	0.000	0.000
M&A$_{t-1}$	1,130	0.228	0.420	0.000	0.000	0.000
VEGA$_{t-1}$	1,130	139.990	238.364	0.000	24.832	173.663
DELTA$_{t-1}$	1,130	926.037	1998.074	0.000	234.103	876.146
LITRISK$_{t-1}$	1,130	0.415	0.275	0.189	0.353	0.593
PCTIND$_{t-1}$	1,130	0.577	0.344	0.375	0.714	0.846
BOARDSIZE$_{t-1}$	1,130	7.087	4.527	5.000	8.000	10.000

Table 3, Continued

Panel B: H1 Sample Split on Shareholder Tax Litigation (*TAXLIT*)								
	TAXLIT= 0			*TAXLIT*= 1			Diff in Means	
Variables	N	Mean	SD	N	Mean	SD	Diff	T-Stat
$GETR_{t-1}$	1,096	0.268	0.195	34	0.231	0.161	0.037	1.097
$CETR_{t-1}$	1,082	0.221	0.197	34	0.242	0.208	-0.021	-0.620
$GAVOIDER_{t-1}$	1,096	0.426	0.495	34	0.529	0.507	-0.103	-1.198
$TAVOIDER_{t-1}$	1,082	0.362	0.481	34	0.412	0.500	-0.049	-0.590
UTB_{t-1}	504	0.017	0.020	17	0.024	0.036	-0.007	-1.351
ROA_{t-1}	1,096	0.117	0.143	34	0.119	0.088	-0.002	-0.081
$SIZE_{t-1}$	1,096	7.890	2.038	34	7.755	1.936	0.135	0.382
LEV_{t-1}	1,096	0.210	0.258	34	0.172	0.150	0.037	0.835
MTB_{t-1}	1,096	3.702	10.426	34	3.619	13.912	0.083	0.045
RET_{t-1}	1,096	0.133	0.918	34	0.307	0.707	-0.174	-1.095
$RETVOL_{t-1}$	1,096	0.123	0.073	34	0.109	0.066	0.384	1.148
NOL_{t-1}	1,096	0.493	0.500	34	0.618	0.493	-0.125	-1.435
ΔNOL_{t-1}	1,096	0.005	0.208	34	0.004	0.103	0.001	0.026
SGA_{t-1}	1,096	0.319	0.295	34	0.365	0.640	-0.046	-0.846
RD_{t-1}	1,096	0.055	0.078	34	0.051	0.071	0.004	0.274
$DACC_{t-1}$	1,096	0.079	0.106	34	0.067	0.074	0.012	0.678
$RESTATE_{t-1}$	1,096	0.192	0.394	34	0.235	0.431	-0.044	-0.635
FI_{t-1}	1,096	0.030	0.045	34	0.035	0.049	-0.005	-0.641
$CAPINT_{t-1}$	1,096	0.256	0.223	34	0.228	0.262	0.028	0.728
$INTANG_{t-1}$	1,096	0.248	0.282	34	0.233	0.275	0.015	0.311
$EQINC_{t-1}$	1,096	0.001	0.004	34	0.000	0.002	0.001	0.991
$M\&A_{t-1}$	1,096	0.227	0.419	34	0.265	0.448	-0.038	-0.513
$VEGA_{t-1}$	1,096	138.909	237.389	34	174.842	269.518	-35.933	-0.866
$DELTA_{t-1}$	1,096	920.189	1983.893	34	1114.560	2439.107	-194.371	-0.559
$LITRISK_{t-1}$	1,096	0.417	0.275	34	0.365	0.262	0.051	1.074
$PCTIND_{t-1}$	1,096	0.573	0.345	34	0.701	0.292	-0.127	-2.127**
$BOARDSIZE_{t-1}$	1,096	7.065	4.553	34	7.794	3.574	-0.729	-0.925

This table presents descriptive statistics for variables used in our tests of H1 on the determinants of shareholder tax litigation overall (Panel A) and separately split on whether the firm had shareholder tax litigation (Panel B). ***, ** and * indicate statistical significance at $p < 0.01$, $p < 0.05$, and $p < 0.10$, respectively, using one-tailed tests for our tax variables of interest and two-tailed tests for all other variables. All variables are defined in Appendix B.

Table 4
Determinants of Shareholder Tax Litigation

	(1)	(2)	(3)	(4)	(5)
$GETR_{t-1}$	-1.997**				
	(-1.715)				
$CETR_{t-1}$		-0.497			
		(-0.332)			
$GAVOIDER_{t-1}$			0.680*		
			(1.620)		
$TAVOIDER_{t-1}$				0.784*	
				(1.476)	
UTB_{t-1}					26.409*
					(1.621)
ROA_{t-1}	0.316	-0.025	0.680	0.559	-1.967
	(0.205)	(-0.016)	(0.447)	(0.342)	(-0.672)
$SIZE_{t-1}$	-0.026	-0.019	-0.026	-0.000	-0.139
	(-0.132)	(-0.085)	(-0.131)	(-0.002)	(-0.383)
LEV_{t-1}	-1.040	-1.005	-1.086	-1.314	0.278
	(-0.935)	(-0.818)	(-0.965)	(-1.037)	(0.126)
MTB_{t-1}	-0.002	-0.001	-0.002	-0.003	-0.029
	(-0.046)	(-0.038)	(-0.070)	(-0.075)	(-0.729)
RET_{t-1}	0.297*	0.280	0.299*	0.306	0.485
	(1.683)	(1.472)	(1.655)	(1.601)	(0.689)
$RETVOL_{t-1}$	-7.341	-7.155	-7.286	-7.723	-8.665
	(-1.234)	(-1.149)	(-1.196)	(-1.269)	(-1.060)
NOL_{t-1}	0.568	0.589	0.579	0.669	1.496***
	(1.378)	(1.417)	(1.417)	(1.568)	(2.696)
ΔNOL_{t-1}	0.603	0.785	0.622	0.883	0.373
	(0.921)	(0.787)	(0.924)	(0.898)	(0.297)
SGA_{t-1}	0.605	0.549	0.537	0.529	-0.159
	(1.097)	(0.938)	(0.986)	(0.984)	(-0.101)
RD_{t-1}	-0.680	-0.169	-0.543	-0.823	-2.714
	(-0.189)	(-0.052)	(-0.157)	(-0.239)	(-0.342)
$DACC_{t-1}$	1.275	1.465	1.263	1.513	-0.172
	(0.643)	(0.693)	(0.609)	(0.687)	(-0.054)
$RESTATE_{t-1}$	0.010	0.039	0.014	0.023	-1.582**
	(0.021)	(0.083)	(0.030)	(0.047)	(-2.064)
FI_{t-1}	-1.686	-1.519	-2.350	-2.204	11.126
	(-0.240)	(-0.206)	(-0.336)	(-0.316)	(0.942)
$CAPINT_{t-1}$	-0.112	-0.054	-0.037	-0.139	0.745
	(-0.058)	(-0.028)	(-0.019)	(-0.071)	(0.220)
$INTANG_{t-1}$	-0.943	-0.942	-0.799	-0.852	0.197
	(-0.664)	(-0.628)	(-0.554)	(-0.565)	(0.109)
$EQINC_{t-1}$	-96.939	-93.114	-90.000	-96.639	-154.264
	(-1.380)	(-1.350)	(-1.321)	(-1.411)	(-1.531)
$M\&A_{t-1}$	0.324	0.315	0.277	0.298	-0.873
	(0.690)	(0.652)	(0.580)	(0.599)	(-1.450)
$VEGA_{t-1}$	0.001	0.001	0.001	0.001	0.003**
	(1.133)	(1.091)	(1.102)	(1.180)	(2.536)
$DELTA_{t-1}$	0.000	0.000	0.000	0.000	-0.000
	(0.526)	(0.593)	(0.491)	(0.464)	(-0.293)
$LITRISK_{t-1}$	0.232	0.364	0.287	0.392	3.022
	(0.335)	(0.547)	(0.416)	(0.587)	(1.320)
$PCTIND_{t-1}$	2.499*	2.282	2.581*	2.283	7.739*
	(1.697)	(1.606)	(1.698)	(1.627)	(1.939)

BOARDSIZE$_{t-1}$	-0.151	-0.144	-0.157	-0.146	-0.563**
	(-1.255)	(-1.251)	(-1.292)	(-1.254)	(-2.289)
GOV_MISSING	Yes	Yes	Yes	Yes	Yes
Industry FE	Yes	Yes	Yes	Yes	Yes
Year FE	Yes	Yes	Yes	Yes	Yes
Observations	835	824	835	824	345
ROC	0.778	0.767	0.775	0.779	0.877

This table presents results of logistic regressions of *TAXLIT* at year *t* on lagged values of our tax variables of interest and control variables. Standard errors are clustered by firm, and t-statistics are shown in parentheses. ***, ** and * indicate statistical significance at $p < 0.01$, $p < 0.05$, and $p < 0.10$, respectively, using one-tailed tests for our tax variables of interest and two-tailed tests for all other variables. All variables are defined in Appendix B.

Table 5
The Effect of Shareholder Tax Litigation on Sued Firm Tax Behavior

Panel A: Covariate Balance

Variables	$TREAT = 0$			$TREAT = 1$			Diff in Means	
	N	Mean	SD	N	Mean	SD	Diff	T-Stat
$GETR_{t-1}$	939	0.238	0.182	111	0.238	0.148	0.000	0.000
ROA	939	0.107	0.095	111	0.107	0.079	0.000	0.000
SIZE	939	7.774	2.127	111	7.774	1.877	0.000	0.000
LEV	939	0.204	0.232	111	0.204	0.336	0.000	0.000
MTB	939	5.608	9.336	111	5.608	7.182	0.000	0.000
RET	939	0.121	0.705	111	0.121	0.557	0.000	0.000
RETVOL	939	0.113	0.065	111	0.113	0.065	0.000	0.000
NOL	939	0.613	0.487	111	0.613	0.489	0.000	0.000
ΔNOL	939	0.001	0.093	111	0.001	0.078	0.000	0.000
SGA	939	0.352	0.377	111	0.352	0.592	0.000	0.000
RD	939	0.047	0.055	111	0.047	0.051	0.000	0.000
DACC	939	0.076	0.098	111	0.076	0.080	0.000	0.000
RESTATE	939	0.261	0.440	111	0.261	0.441	0.000	0.000
FI	939	0.040	0.046	111	0.040	0.045	0.000	0.000
CAPINT	939	0.197	0.162	111	0.197	0.200	0.000	0.000
INTANG	939	0.232	0.254	111	0.232	0.274	0.000	0.000
EQINC	939	0.001	0.005	111	0.001	0.005	0.000	0.000
M&A	939	0.207	0.405	111	0.207	0.407	0.000	0.000
VEGA	939	175.700	285.507	111	175.700	274.592	0.000	0.000
DELTA	939	922.400	2130.463	111	922.400	2223.787	0.000	0.000
LITRISK	939	0.371	0.261	111	0.371	0.250	0.000	0.000
PCTIND	939	0.649	0.321	111	0.649	0.333	0.000	0.000
BOARDSIZE	939	7.054	3.951	111	7.054	3.833	0.000	0.000

Panel B: Regression Results for Shareholder Tax Litigation and Sued Firm Tax Avoidance

Variables	(1) GETR	(2) CETR	(3) GAVOIDER	(4) TAVOIDER	(5) UTB
TREAT	-0.031	-0.028	0.446	0.287	0.001
	(-1.568)	(-1.225)	(1.223)	(0.699)	(0.113)
POST	-0.038**	-0.044**	0.800***	0.677**	0.002
	(-1.997)	(-2.128)	(2.883)	(2.260)	(0.738)
TREAT * POST	0.068**	0.043*	-2.049***	-0.697*	-0.001
	(1.920)	(1.327)	(-3.710)	(-1.372)	(-0.145)
ROA	0.300***	-0.201	-12.026***	-2.674	0.034
	(2.640)	(-1.629)	(-4.517)	(-1.341)	(1.401)
SIZE	-0.003	0.001	0.003	-0.318**	-0.001
	(-0.347)	(0.162)	(0.023)	(-2.325)	(-0.812)
LEV	-0.008	-0.093***	0.587	2.108***	0.004
	(-0.207)	(-2.634)	(0.805)	(2.927)	(0.561)
MTB	-0.003**	-0.002**	0.018	0.032	0.000*
	(-2.304)	(-2.062)	(1.046)	(1.577)	(1.761)
RET	-0.037***	-0.048***	0.746***	0.501	-0.001
	(-3.814)	(-3.379)	(2.787)	(1.552)	(-0.419)
RETVOL	-0.097	-0.025	2.385	3.295	-0.071
	(-0.484)	(-0.158)	(0.759)	(1.051)	(-1.212)
NOL	0.010	0.019	-0.032	-0.388	-0.003
	(0.403)	(1.029)	(-0.106)	(-1.239)	(-1.020)
ΔNOL	0.062	-0.117	-0.683	1.483	-0.029*
	(0.786)	(-1.403)	(-0.623)	(1.545)	(-1.811)
SGA	-0.009	0.093***	0.562	-1.553***	-0.001
	(-0.444)	(2.871)	(1.618)	(-2.690)	(-0.056)
RD	-0.184	-0.138	1.535	1.564	-0.063
	(-0.860)	(-0.715)	(0.474)	(0.542)	(-1.218)
DACC	-0.097	-0.147	3.032*	3.026	0.047**
	(-0.883)	(-1.205)	(1.649)	(1.575)	(2.483)
RESTATE	-0.008	-0.018	0.334	0.671*	-0.001
	(-0.287)	(-0.760)	(0.925)	(1.882)	(-0.383)
FI	-0.422**	-0.752***	9.775**	7.750**	0.083**
	(-2.018)	(-3.897)	(2.285)	(2.217)	(2.391)
CAPINT	-0.055	0.091	-0.422	0.194	-0.040***
	(-1.200)	(1.337)	(-0.513)	(0.211)	(-3.078)
INTANG	-0.061*	0.097**	0.799	-1.179*	-0.002
	(-1.686)	(2.248)	(1.153)	(-1.760)	(-0.310)
EQINC	2.555	3.245*	-35.147	-44.925	-0.188
	(1.320)	(1.708)	(-0.929)	(-1.130)	(-0.459)
M&A	-0.019	-0.059**	0.636	0.200	0.004
	(-0.776)	(-2.560)	(1.602)	(0.697)	(1.025)
VEGA	0.000	0.000	0.001*	-0.000	-0.000
	(0.158)	(0.894)	(1.662)	(-0.242)	(-1.303)
DELTA	0.000**	0.000	-0.000	0.000***	0.000
	(2.412)	(0.765)	(-1.158)	(3.165)	(0.446)
LITRISK	-0.085**	0.026	0.961	0.234	0.010
	(-2.196)	(0.578)	(1.460)	(0.385)	(1.004)
PCTIND	0.020	0.037	0.575	1.740	-0.062
	(0.288)	(0.431)	(0.534)	(1.419)	(-1.656)
BOARDSIZE	-0.009*	0.007	0.230***	-0.071	0.000
	(-1.794)	(1.241)	(2.799)	(-0.828)	(0.258)
CETR					-0.018***

				(-2.982)
GOV_MISSING	Yes	Yes	Yes	Yes	Yes
Industry FE	Yes	Yes	Yes	Yes	Yes
Year FE	Yes	Yes	Yes	Yes	Yes
Observations	1,050	1,050	1,037	1,050	438
Adjusted/Pseudo R²	0.208	0.261	0.335	0.278	0.435

This table reports the covariate balance for our entropy balanced sample (Panel A) and results of weighted OLS (Columns 1, 2 and 5) and weighted logistic regressions (Columns 3 and 4) of our tax measures of interest on indicator variables for treatment firms and post-focal firm litigation periods, an interaction of the treatment and post variables, and control variables (Panel B). Treated firms are those with shareholder tax litigation; control firms are those with non-tax shareholder litigation in the same Fama-French 48 industry and with a class period end in the same year as the tax litigation firm. *POST* is measured as of the end of the class period for each firm. We entropy balance our sample using all control variables, but for ease of exposition, present the covariate balance for only our main control variables (i.e., excluding *POST*). t-statistics are shown in parentheses. Standard errors are clustered by firm. ***, **, and * indicate statistical significance at $p < 0.01$, $p < 0.05$, and $p < 0.10$, respectively, using one-tailed tests for our variables of interest and two-tailed tests for all other variables. Variables are defined in Appendix B.

Table 6
Spillover Effects of Shareholder Tax Litigation

Panel A: Covariate Balance

Variables	*TREATPEER* = 0			*TREATPEER* = 1			Diff in Means	
	N	Mean	SD	N	Mean	SD	Diff	T-Stat
$GETR_{t-1}$	1,650	0.279	0.207	1,049	0.279	0.164	0.000	0.000
ROA	1,650	0.123	0.110	1,049	0.123	0.079	0.000	0.000
SIZE	1,650	7.494	2.243	1,049	7.494	1.686	0.000	0.000
LEV	1,650	0.199	0.257	1,049	0.199	0.227	0.000	0.000
MTB	1,650	3.196	5.805	1,049	3.196	7.836	0.000	0.000
RET	1,650	0.211	0.676	1,049	0.211	0.907	0.000	0.000
RETVOL	1,650	0.136	0.075	1,049	0.136	0.100	0.000	0.000
NOL	1,650	0.501	0.500	1,049	0.501	0.500	0.000	0.000
ΔNOL	1,650	0.015	0.294	1,049	0.015	0.149	0.000	0.000
SGA	1,650	0.298	0.298	1,049	0.298	0.313	0.000	0.000
RD	1,650	0.034	0.061	1,049	0.034	0.075	0.000	0.000
DACC	1,650	0.076	0.096	1,049	0.076	0.092	0.000	0.000
RESTATE	1,650	0.098	0.298	1,049	0.098	0.298	0.000	0.000
FI	1,650	0.026	0.044	1,049	0.026	0.044	0.000	0.000
CAPINT	1,650	0.280	0.311	1,049	0.280	0.276	0.000	0.000
INTANG	1,650	0.247	0.288	1,049	0.247	0.257	0.000	0.000
EQINC	1,650	0.001	0.005	1,049	0.001	0.005	0.000	0.000
M&A	1,650	0.159	0.366	1,049	0.159	0.366	0.000	0.000
VEGA	1,650	77.180	180.801	1,049	77.180	170.658	0.000	0.000
DELTA	1,650	623.100	1682.142	1,049	623.100	1889.065	0.000	0.000
LITRISK	1,650	0.478	0.273	1,049	0.478	0.317	0.000	0.000
PCTIND	1,650	0.601	0.333	1,049	0.601	0.340	0.000	0.000
BOARDSIZE	1,650	6.800	4.021	1,049	6.800	4.019	0.000	0.000

Panel B: Regression Results for Shareholder Tax Litigation and Peer Firm Tax Avoidance

Variables	(1) GETR	(2) CETR	(3) GAVOIDER	(4) TAVOIDER	(5) UTB
TREATPEER	-0.022	-0.016	0.416	0.438	-0.001
	(-0.898)	(-0.806)	(1.274)	(1.392)	(-0.510)
POSTPEER	-0.056**	-0.069**	0.785*	0.944**	0.006*
	(-2.023)	(-2.464)	(1.841)	(2.148)	(1.776)
TREATPEER * POSTPEER	0.062**	0.065***	-0.929**	-0.624*	-0.007**
	(2.106)	(2.409)	(-2.124)	(-1.418)	(-2.016)
ROA	0.040	0.032	-4.417***	-3.368***	0.005
	(0.543)	(0.443)	(-3.223)	(-3.311)	(0.370)
SIZE	0.010	0.015**	0.048	-0.287***	0.005***
	(1.591)	(2.559)	(0.538)	(-3.384)	(4.073)
LEV	-0.012	-0.102***	-0.108	1.488***	0.008*
	(-0.286)	(-2.959)	(-0.179)	(2.972)	(1.694)
MTB	-0.001*	-0.001	0.024*	0.007	-0.000
	(-1.792)	(-1.203)	(1.737)	(0.484)	(-0.043)
RET	-0.017	-0.041***	0.579***	0.520***	0.001
	(-0.998)	(-4.629)	(2.934)	(3.872)	(1.372)
RETVOL	0.445***	-0.061	-3.094*	2.733	-0.016
	(3.191)	(-0.531)	(-1.674)	(1.558)	(-1.100)
NOL	0.011	-0.026*	-0.344	0.644***	-0.000
	(0.758)	(-1.927)	(-1.469)	(2.867)	(-0.181)
ΔNOL	-0.034	0.000	0.314	-0.233	0.002
	(-1.606)	(0.023)	(0.983)	(-0.455)	(0.299)
SGA	0.024	0.058	-0.742	-0.281	0.008
	(0.819)	(1.556)	(-1.366)	(-0.479)	(1.565)
RD	-0.316**	-0.487***	8.989***	8.856***	0.040*
	(-2.558)	(-3.708)	(4.310)	(4.220)	(1.697)
DACC	-0.188**	0.067	2.879**	-1.272	0.011
	(-2.393)	(0.901)	(2.373)	(-1.248)	(0.731)
RESTATE	-0.077***	-0.023	1.177***	0.658*	-0.002
	(-3.688)	(-0.994)	(3.829)	(1.922)	(-0.767)
FI	-0.289*	-0.030	8.575***	-7.944**	0.200***
	(-1.847)	(-0.163)	(3.082)	(-2.257)	(4.457)
CAPINT	0.062	-0.033	-0.333	0.674	-0.015***
	(1.456)	(-0.773)	(-0.496)	(1.304)	(-2.929)
INTANG	-0.013	-0.016	-0.123	-0.130	-0.006
	(-0.463)	(-0.550)	(-0.264)	(-0.276)	(-0.991)
EQINC	-1.953	-0.986	9.452	16.682	-0.787***
	(-1.038)	(-0.544)	(0.363)	(0.608)	(-3.435)
M&A	-0.046**	0.023	0.626**	-0.332	-0.002
	(-2.427)	(1.130)	(2.438)	(-1.264)	(-0.749)
VEGA	-0.000	-0.000	-0.000	0.001	-0.000
	(-0.614)	(-0.470)	(-0.485)	(0.893)	(-1.609)
DELTA	0.000	-0.000	-0.000	0.000	-0.000
	(0.205)	(-0.882)	(-0.937)	(0.762)	(-1.452)
LITRISK	-0.048**	-0.038	0.842*	0.825*	-0.005
	(-2.071)	(-1.244)	(1.695)	(1.904)	(-0.696)
PCTIND	-0.018	0.071	-0.040	-0.458	0.019**
	(-0.337)	(1.279)	(-0.041)	(-0.502)	(2.406)
BOARDSIZE	0.003	0.001	-0.097	-0.038	-0.002***
	(0.671)	(0.154)	(-1.437)	(-0.537)	(-2.657)
CETR					0.004
					(0.856)

GOV_MISSING	Yes	Yes	Yes	Yes	Yes
Industry FE	Yes	Yes	Yes	Yes	Yes
Year FE	Yes	Yes	Yes	Yes	Yes
Observations	2,699	2,699	2,699	2,699	1,288
Adjusted/Pseudo R²	0.203	0.183	0.251	0.305	0.541

This table reports the covariate balance for our entropy balanced sample (Panel A) and results of weighted OLS (Columns 1, 2 and 5) and weighted logistic regressions (Columns 3 and 4) of our tax measures of interest on indicator variables for treatment firms and post-focal firm litigation periods, an interaction of the treatment and post variables, and control variables (Panel B). Treated firms are those in the highest tercile of industry litigation risk and the same Fama-French 48 industry and year as the sued focal firm; control firms are those in the lowest tercile of industry litigation risk and same Fama-French 48 industry and year as the sued focal firm. *POSTPEER* is measured as of the filing date of the sued firm's shareholder tax litigation. We entropy balance our sample using all control variables, but for ease of exposition, present the covariate balance for only our main control variables (i.e., excluding *POSTPEER*). t-statistics are shown in parentheses. Standard errors are clustered by firm. ***, **, and * indicate statistical significance at $p < 0.01$, $p < 0.05$, and $p < 0.10$, respectively, using one-tailed tests for our variables of interest and two-tailed tests for all other variables. Variables are defined in Appendix B.

Table 7
Sued Firm Product Market Power and Spillover Effects of Shareholder Tax Litigation

Variables	(1) GETR	(2) CETR	(3) GAVOIDER	(4) TAVOIDER	(5) UTB
TREATPEER	0.013	0.023	-0.073	-0.090	-0.005
	(0.661)	(1.262)	(-0.226)	(-0.283)	(-1.444)
POSTPEER	0.021	0.026	0.091	-0.255	0.003
	(0.988)	(1.022)	(0.178)	(-0.599)	(0.675)
TREATPEER * POSTPEER	0.009	0.013	-0.141	-0.106	-0.005
	(0.385)	(0.533)	(-0.306)	(-0.263)	(-0.975)
PML	-0.028	0.073*	0.120	-1.073	0.002
	(-0.556)	(1.717)	(0.157)	(-1.372)	(0.301)
PML * TREATPEER	-0.131***	-0.172***	1.054	2.573***	-0.006
	(-2.961)	(-3.701)	(1.227)	(3.456)	(-0.837)
PML * POSTPEER	-0.082**	-0.113***	1.039*	1.676***	0.004
	(-2.579)	(-3.549)	(1.915)	(2.666)	(0.585)
PML * TREATPEER * POSTPEER	0.114***	0.090**	-1.319**	-1.186**	0.001
	(2.827)	(2.080)	(-1.865)	(-1.924)	(0.089)
Controls	Yes	Yes	Yes	Yes	Yes
Industry FE	Yes	Yes	Yes	Yes	Yes
Year FE	Yes	Yes	Yes	Yes	Yes
Observations	2,699	2,699	2,699	2,699	1,288
Adjusted/Pseudo R²	0.205	0.203	0.265	0.334	0.496

This table presents results of weighted OLS (Columns 1,2 and 5) and weighted logistic regressions (Columns 3 and 4) of our tax measures of interest on indicator variables for treatment firms, post-focal firm litigation periods and sued focal firms who are product market leaders, interactions of each of these variables, and control variables. Treated firms are those in the highest tercile of industry litigation risk and the same Fama-French 48 industry and year as the sued focal firm; control firms are those in the lowest tercile of industry litigation risk and same Fama-French 48 industry and year as the sued focal firm. *POSTPEER* is measured as of the filing date of the focal firm's shareholder tax litigation. t-statistics are shown in parentheses. Standard errors are clustered by firm. ***, **, and * indicate statistical significance at $p < 0.01$, $p < 0.05$, and $p < 0.10$, respectively, using one-tailed tests for our variables of interest and two-tailed tests for all other variables. Variables are defined in Appendix B.

Table 8
Sued Firm Media Coverage and Spillover Effects of Shareholder Tax Litigation

Variables	(1) GETR	(2) CETR	(3) GAVOIDER	(4) TAVOIDER	(5) UTB
TREATPEER	0.000	-0.013	0.129	0.283	0.001
	(0.009)	(-0.656)	(0.416)	(0.830)	(0.262)
POSTPEER	0.005	-0.012	-0.101	0.258	0.008**
	(0.258)	(-0.499)	(-0.280)	(0.671)	(1.972)
TREATPEER * POSTPEER	0.011	0.013	-0.146	-0.153	-0.007*
	(0.491)	(0.527)	(-0.359)	(-0.390)	(-1.955)
HIMEDIA	0.058	0.281***	-0.971	-9.504***	0.012
	(0.705)	(3.819)	(-0.990)	(-5.061)	(1.286)
HIMEDIA * TREATPEER	-0.101**	-0.117***	1.215**	1.652***	-0.007*
	(-2.170)	(-2.821)	(2.125)	(3.348)	(-1.771)
HIMEDIA * POSTPEER	-0.052	0.001	0.414	0.342	-0.002
	(-1.298)	(0.021)	(0.721)	(0.630)	(-0.341)
HIMEDIA * TREATPEER * POSTPEER	0.097**	0.115***	-0.862*	-1.180**	0.006
	(1.986)	(2.549)	(-1.423)	(-2.042)	(1.277)
Controls	Yes	Yes	Yes	Yes	Yes
Industry FE	Yes	Yes	Yes	Yes	Yes
Year FE	Yes	Yes	Yes	Yes	Yes
Observations	2,699	2,699	2,699	2,699	1,288
Adjusted/Pseudo R²	0.164	0.200	0.220	0.295	0.350

This table presents results of weighted OLS (Columns 1,2 and 5) and weighted logistic regressions (Columns 3 and 4) of our tax measures of interest on indicator variables for treatment firms, post-focal firm litigation periods and sued focal firms who have high levels of abnormal media coverage, interactions of each of these variables, and control variables. Treated firms are those in the highest tercile of industry litigation risk and the same Fama-French 48 industry and year as the sued focal firm; control firms are those in the lowest tercile of industry litigation risk and same Fama-French 48 industry and year as the sued focal firm. *POSTPEER* is measured as of the filing date of the focal firm's shareholder tax litigation. t-statistics are shown in parentheses. Standard errors are clustered by firm. ***, **, and * indicate statistical significance at $p < 0.01$, $p < 0.05$, and $p < 0.10$, respectively, using one-tailed tests for our variables of interest and two-tailed tests for all other variables. Variables are defined in Appendix B.

Table 9
Tests of Pre-Event Changes in Tax Avoidance

Panel A: Tests of Differences in Pre-Period Tax Avoidance Growth Rates for Treatment and Control Firms for H2

Variables	N	Treatment	Control	Diff	T-Stat
GETR	482	0.301	0.269	0.032	-0.062
CETR	483	0.366	3.937	-3.571	0.391
UTB	178	0.209	6.749	-6.539	0.336

Panel B: Tests of Differences in Pre-Period Tax Avoidance Growth Rates for Treatment and Control Firms for H3

Variables	N	Treatment	Control	Diff	T-Stat
GETR	1,187	0.067	0.943	-0.877	0.956
CETR	1,173	6.331	1.164	5.167	-1.460
UTB	365	0.006	9.680	-9.674	-1.154

This table presents results from t-tests of differences in growth rates of our tax variables of interest for H2 (Panel A) and H3 (Panel B). ***, **, and * indicate statistical significance at $p < 0.01$, $p < 0.05$, and $p < 0.10$, respectively (two-tailed).

Table 10
Falsification Tests

Panel A: Focal Firm Shareholder Tax Litigation

Variables	(1) GETR	(2) CETR	(3) GAVOIDER	(4) TAVOIDER	(5) UTB
TREAT	0.016	0.023	-0.420	0.267	-0.011***
	(0.774)	(0.756)	(-0.986)	(0.703)	(-3.301)
POST	-0.008	-0.007	0.336	0.282	0.001
	(-0.639)	(-0.374)	(1.168)	(1.062)	(0.565)
TREAT * POST	-0.009	-0.013	-0.350	-0.248	-0.002
	(-0.315)	(-0.424)	(-0.558)	(-0.483)	(-0.579)
Controls	Yes	Yes	Yes	Yes	Yes
Industry FE	Yes	Yes	Yes	Yes	Yes
Year FE	Yes	Yes	Yes	Yes	Yes
Observations	1,036	1,036	1,023	1,026	420
Adjusted/Pseudo R²	0.225	0.244	0.299	0.285	0.400

Panel B: Spillover Effects of Shareholder Tax Litigation

Variables	(1) GETR	(2) CETR	(3) GAVOIDER	(4) TAVOIDER	(5) UTB
TREATPEER	0.005	-0.020	0.462*	0.480**	0.004*
	(0.300)	(-1.055)	(1.873)	(2.182)	(1.860)
POSTPEER	0.018	0.019	-0.062	-0.349	0.002
	(0.981)	(0.975)	(-0.214)	(-1.109)	(0.601)
TREATPEER * POSTPEER	-0.004	0.031*	-0.051	-0.239	-0.001
	(-0.243)	(1.530)	(-0.185)	(-0.842)	(-0.407)
Controls	Yes	Yes	Yes	Yes	Yes
Industry FE	Yes	Yes	Yes	Yes	Yes
Year FE	Yes	Yes	Yes	Yes	Yes
Observations	2,896	2,896	2,893	2,896	1,064
Adjusted/Pseudo R²	0.143	0.183	0.221	0.227	0.271

This table presents results of weighted OLS (Columns 1,2 and 5) and weighted logistic regressions (Columns 3 and 4) of our tax measures of interest on indicator variables for treatment firms and post-focal firm litigation periods, an interaction of the treatment and post variables, and control variables, using pseudo-filing and class period end dates set three years before the respective date (Jiang et al. 2019). In Panel A, treated firms are those with shareholder tax litigation which has a pseudo-class period end in a given year while control firms are those with non-tax shareholder litigation in the same Fama-French 48 industry and with a pseudo-class period end in the same year as the tax litigation firm. *POST* is measured as of the end of the pseudo-class period for each firm in Panel B. In Panel B, treated firms are those in the highest tercile of industry litigation risk and the same Fama-French 48 industry as the sued focal firm; control firms are those in the lowest tercile of industry litigation risk and same Fama-French 48 industry as the sued focal firm. *POSTPEER* is measured as of the pseudo-filing date of the focal firm's shareholder tax litigation for Panel B. t-statistics are shown in parentheses. Standard errors are clustered by firm. ***, **, and * indicate statistical significance at $p < 0.01$, $p < 0.05$, and $p < 0.10$, respectively, using one-tailed tests for our variables of interest and two-tailed tests for all other variables. Variables are defined in Appendix B.