Foreign Tax Credit Hyping and American Competitiveness in the Foreign Mergers and Acquisitions Market

by

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DISSERTATION ABSTRACT

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Title: Foreign Tax Credit Hyping and American Competitiveness in the Foreign Mergers and Acquisition Market

This study examines how foreign direct investment disincentives affect U.S. multinationals' acquisition decisions, deal pricing, and financial reporting. I exploit a natural experiment provided by the Education, Jobs, and Medicaid Assistance Act of 2010, which curtails foreign tax credit benefits for certain cross-border acquisitions, known as covered asset acquisitions under §901(m). Using transaction-, firm-, and country-level data on over 19,000 global public and private M&A deals from 2000 to 2015, I find that prior to the reform, U.S. acquirers are more likely to structure acquisitions of foreign targets as taxable stock acquisitions, consistent with incentives to increase foreign tax credits through cross-border transactions. Following the reform, U.S. firms, relative to foreign firms, are 8 to 9 percentage points less likely to use taxable stock acquisitions in cross-border acquisitions, with declines concentrated among high-tax targets. I further show that U.S. acquirers capitalize these benefits into acquisition price, paying 4 to 5 percent higher acquisition prices for foreign targets in taxable stock acquisitions prior to the reform, with these differentials disappearing afterward. Finally, U.S. firms engaging in these transactions after the reform increase permanently reinvested earnings, consistent with higher repatriation costs on post-acquisition foreign earnings. Together, these findings indicate that foreign direct investment decisions respond to targeted tax disincentives influencing acquisition structure, pricing, and financial reporting. Further these disincentives may have weakened U.S. firms' competitiveness in foreign acquisition markets.

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CHAPTER I

INTRODUCTION

Foreign direct investment by U.S. firms reached $9.4 trillion at the end of 2023, representing over 21% of global investment activity, making it the largest foreign investment position of any country (UNCTAD 2024). One of the primary forms of foreign direct investment is the acquisition of existing businesses through mergers and acquisitions (M&A). In 2023, global M&A activity totaled $2.9 trillion, with approximately one-third of that value attributable to cross-border M&A and just over half of that value attributable to transactions with some U.S. involvement (LSEG Data & Analytics 2024). Additionally, U.S. multinationals earned income of $577 billion on their cumulative investment abroad in 2023 (BEA 2024).

While market access and strategic expansion motivate much of this activity, tax considerations also play a critical role in shaping cross-border M&A (Hines 1996; Huizinga and Voget 2009; Feld, Ruf, Scheuering, Schreiber, and Voget 2016; Arulampalam, Devereux, and Liberini 2019; Bradley, Ruf, and Robinson 2021; Blouin, Fich, Rice, and Tran 2021; Bührule, Casi-Eberhand, Stage, and Voget 2023; Amberger and Robinson 2024). For instance, higher statutory tax rates in the target country reduce the likelihood of an acquisition in that country, with the effect moderated by the acquirer country tax system (Arulampalam *et al.* 2019). More recent work by Bührule *et al.* (2023) highlights that even non-tax rate provisions, such as post-acquisition limitations on the use of tax loss carryforwards, can meaningfully alter acquisition activity, suggesting that firms are sensitive not only to tax rates but also the institutional design of tax rules.

Prior to 2018, the U.S. taxed foreign direct investment income but also granted a foreign tax credit (FTC) for foreign taxes paid to mitigate double taxation of foreign income; this policy

is consistent with capital *export* neutrality (*i.e.*, indifference between investing at home or abroad by taxing the investment's income the same regardless of where it is earned). The rationale for capital export neutrality is grounded in the view that U.S. foreign investment produces net benefits for both the investing firms and the broader U.S. economy, directing investors towards pre-tax profitability and deemphasizing *where* taxes are paid.

However, actions by the first and second Trump administrations challenge this thinking. The 2017 Tax Cuts and Jobs Act introduces a dividends received deduction for certain active foreign-sourced dividends, moving toward a territorial system consistent with capital *import* neutrality (within country investments face the same tax treatment, regardless of the investor's location).[1] Coupled with a 14-point decrease in the corporate tax rate (35 to 21%) and other targeted provisions, the bill encourages investment within the United States. The 2025 One Big Beautiful Bill Act reinforces the quasi-territoriality approach and makes permanent immediate expensing for a broad set of domestic investment, strengthening domestic investment incentives.[2] Initiated in early 2025, the America First Trade Policy emphasizes concerns about the domestic consequences of cross-border economic activity (The White House 2025b, c).

Given the shift in U.S. policy regarding the importance of the location of investment, I seek to understand how, and to what extent, multinational enterprises respond to disincentives for foreign direct investment. Studying the Trump administrations' tax policies directly complicates empirical identification because myriad provisions were enacted simultaneously,

[1] An Act to provide for reconciliation pursuant to titles II and V of the concurrent resolution on the budget for fiscal year 2018, Public Law (Pub. L.) 115-97, 131 Stat. 2054 (December 22, 2017); Internal Revenue Code Section (§) 245A.

[2] An Act to provide for reconciliation pursuant to the concurrent resolution on the budget for fiscal year 2025, Pub. L. 119-21, 139 Stat. 72 (July 4, 2025); §168(k).

creating both benefits and costs across individual and business taxation—the bills exceed 1,000 pages with trillions of dollars in estimated fiscal impact. To answer my research question, I instead exploit a natural experiment using Pub. L. 111-226, informally known as the Education, Jobs, and Medicaid Assistance Act of 2010 (2010 Act).[3] This law change is an ideal setting to measure the effect of disincentives on U.S. multinationals' foreign direct investment decisions because the reform (1) curtails tax benefits of foreign direct investment, (2) introduces plausibly exogenous variation in a narrowly defined set of cross-border M&A transactions, and (3) preserves the capital export neutrality framework that existed before the Tax Cut and Jobs Act.

The 2010 Act provides emergency funding for education, jobs, and Medicaid assistance in the aftermath of the global financial crisis, with revenue-raising tax provisions to offset its budgetary costs. Central among these offsets is the closure of what policymakers characterize as abusive cross-border tax planning strategies that allow U.S. multinationals to artificially inflate foreign tax credits—"FTC hyping". FTC hyping refers to strategies that reduce U.S. tax on foreign income with FTCs without increasing the amount of foreign taxes paid, often by exploiting structural differences between the U.S. and foreign tax systems. In practice, these strategies are frequently implemented through cross-border M&A.

To illustrate, consider a U.S. firm (acquirer) that purchases shares of a foreign company (target) for $100 million, where the target's existing asset basis for tax purposes is $50 million. Due to the nature of a stock acquisition, the target's tax basis in the assets remains $50 million after the transaction. However, assume the acquirer makes a tax election to treat the stock

[3] 124 Stat. 2389 (August 10, 2010).

purchase as an asset purchase for U.S. tax purposes.[4] The election increases the target's U.S. tax basis in the assets from $50 million to $100 million, the fair market value paid for the stock, but the tax basis in the assets for foreign tax purposes remains $50 million. As a result, depreciation and amortization deductions for U.S. tax purposes exceed those recognized for foreign tax purposes. The foreign income taxable in the U.S. (*i.e.*, U.S. tax base) is less than the foreign income taxable in the foreign country (*i.e.*, foreign tax base), but foreign taxes paid is unchanged. Thus, foreign tax credits are a higher percentage of the U.S. tax base than that of the foreign tax base (U.S. Senate Committee on Finance 2010).[5] In other words, FTCs are "hyped" because the U.S. tax base is reduced by greater cost recovery deductions, while the foreign taxes are assessed on a higher, unchanged foreign tax base. This tax outcome is specifically confirmed by the Office of Chief Counsel at the Internal Revenue Service.[6]

Congress however, viewing this outcome as abusive, passed the 2010 Act restricting creditability of foreign taxes paid by foreign targets acquired in transactions treated as asset acquisitions for U.S. tax purposes but as stock acquisitions for foreign tax purposes—coined "covered asset acquisitions" (CAAs) in §901(m). For each CAA with a definitive agreement effective after December 31, 2010, the 2010 Act disqualifies a portion of foreign taxes otherwise allowable as a credit. The limitation is based on acquired asset basis differences between the U.S.

[4] §338 allows a purchasing corporation to elect to treat a qualified stock purchase (acquiring 80% of the vote and value of the target within 12 months) as an asset acquisition by deeming the target to have sold all its assets to a new target corporation acquired by the purchaser. This results in the acquirer taking a fair market value basis in both the shares of, and assets in, the target corporation.

[5] *See* Appendix A for a detailed example.

[6] Internal Revenue Service (IRS), Chief Counsel Advice Memorandum 2007-006, "Elections Under § 338 With Respect to Foreign Corporate Targets," February 9, 2007, which concludes in part, "a domestic…corporation…can make a §338 election for the foreign target and thereby obtain a step-up in the basis of the foreign target's assets *even if no U.S. or foreign tax is incurred*." [*emphasis added*]

and foreign tax rules. Disqualifying FTCs decreases the after-tax profitability of acquiring foreign targets; if firms respond to foreign direct investment disincentives enacted through the U.S. tax system, affected cross-border acquisition structures should decline relative to unaffected transactions.

To test my prediction, I use a difference-in-difference research design that compares acquisition behavior using a five-year window before and after the 2010 Act's effective date. The design exploits variation across acquirer locations (U.S. *vs.* foreign), acquisition structures (CAA *vs.* non-CAA) and time, while controlling for target country characteristics (statutory corporate tax rates) acquirer-level attributes (*e.g.*, size, profitability, growth, leverage, working capital), and industry-year fixed effects. Using M&A transaction-level data from the S&P Capital IQ Transactions database, I estimate the likelihood of acquisition activity using linear probability regressions and Poisson-Pseudo Maximum Likelihood estimation (Amberger and Robinson 2024, Silva and Tenreyro 2006). My primary analysis compares cross-border M&A by U.S. multinationals—affected by the 2010 law's FTC limitations—with that of unaffected transactions by U.S. and foreign multinationals.

Spanning 2000 to 2015, my sample includes over 19,000 M&A transactions with approximately 69% of targets located outside the United States. To establish pre-reform acquisition patterns, I first develop a framework that links FTC hyping incentives to acquisition structure, predicting that U.S. firms are more likely to use taxable stock acquisitions (TSAs)—the acquisition of target equity for cash or other assets—when acquiring foreign, rather than domestic, targets. My empirical results support my predictions: U.S. acquirers are more likely to use TSAs when acquiring foreign targets relative to U.S. targets. Expanding the sample to include foreign acquirers, U.S. acquirers are less likely to use TSAs for home-country targets

relative to foreign acquirers but exhibit an additional increase in the likelihood of using TSAs when acquiring foreign targets. Taken together, the evidence is consistent with FTC hyping increasing the relative attractiveness of foreign TSAs for U.S. acquirers prior to the reform.

The 2010 legislation restricts the creditability of foreign taxes paid following a CAA. I proxy for CAAs using cross-border TSAs (XB TSAs), where a U.S. acquirer has control of a foreign target after the transaction as these transactions provide an opportunity for FTC hyping. In my main tests, I find a statistically significant overall decline—between 8 and 9 percentage points—in the likelihood that U.S. acquirers, relative to foreign acquirers, structure cross-border M&A as taxable stock acquisitions following the 2010 Act consistent with the law selectively deterring acquisition structures where FTC hyping benefits are limited by the legislation. In cross-sectional analyses, I find the decline is concentrated among transactions with high-tax targets, consistent with greater target country tax rates discouraging acquisitions (Arulampalam *et al.* 2019).

In addition to transaction structuring, I examine acquisition premiums and overall transaction prices to assess whether FTC hyping is reflected in deal pricing. These tests speak directly to the competitiveness of U.S. acquirers in foreign M&A markets and to whether tax advantages are capitalized into acquisition prices, as predicted by my model. With respect to acquisition prices among U.S. acquirers prior to the reform, I find 2 to 4% lower premiums for foreign targets relative to U.S. targets in TSA transactions; however, in comparison to foreign acquirers, U.S. acquirers pay 4 to 5% higher acquisition prices for foreign targets in TSAs, robust to the inclusion or exclusion of domestic targets in the sample. These findings are consistent with tax benefits being capitalized into prices, with higher prices paid for acquisitions that generate greater tax saving opportunities. Following the reform, pricing differentials

dissipate, suggesting that limiting cross-border tax planning opportunities reduce the relative attractiveness of these transactions for U.S. firms, particularly where FTC hyping previously enabled more aggressive bidding. In that sense, the reform may have weakened U.S. firms' competitive position in the foreign M&A market by increasing the effective tax cost of acquisitions relative to foreign bidders.

For all years in my sample, U.S. acquirers' foreign earnings of acquired foreign targets are subject to U.S. tax upon repatriation. Therefore, reform limiting FTC availability increases the repatriation cost of foreign earnings associated with CAAs. To examine the magnitude of the reform's impact, I analyze whether the increased repatriation cost is reflected in financial reporting through firms' assertions of permanently reinvested earnings (PRE), which captures management's intent and ability to indefinitely reinvest foreign earnings. Using firm-year panel data from Compustat and Audit Analytics, I evaluate whether U.S. multinationals that completed XB TSAs after 2010 increased foreign earnings designated as PRE to defer U.S. tax expense recognition under U.S. GAAP. I measure PRE one of three ways, capturing the level, whether there is a positive change, and the percentage change in PRE.

I find that firms completing XB TSAs after the reform, my CAA proxy, increase PRE reporting across all three measures of PRE relative to those U.S. multinationals that did not complete XB TSAs. These findings suggest that limiting FTC hyping not only altered acquisition behavior and pricing but also increased the tax cost of repatriation, leading firms to adjust both real investment and financial reporting decisions in response to foreign direct investment disincentives.

This study contributes to literatures across accounting, finance, and public economics on corporate taxation, mergers and acquisitions, and international tax policy in several ways. First, I

provide evidence that cross-border acquisition activity is economically responsive to tax planning opportunities embedded in the FTC system. I document that U.S. acquirers are between 8 and 9 percentage points less likely to structure the acquisition of a cross-border target as a TSA following the 2010 Act, an economically meaningful decline relative to pre-reform activity. This effect implies that roughly $141.3 billion in cross-border transaction value shifted away from taxable stock acquisition structures following the reform. This finding corroborates prior evidence that taxes influence acquisition activity (Hines 1996; Huizinga and Voget 2009; Arulampalam *et al.* 2019; Bradley *et al.* 2021; Bührule *et al.* 2023) by identifying a novel channel—FTC hyping—through which international tax rules affect acquisition structure and real investment decisions.

Second, I extend and refine prior work on tax-motivated acquisition structuring. Erickson and Wang (2000, 2007) show that domestic asset step-ups through TSAs provide insufficient benefits for U.S. C corporation targets. In contrast, I show through theory and empirically that in a cross-border setting, similar transactions of foreign targets can generate substantial tax benefits through FTC hyping, making them both more prevalent and more valuable for U.S. acquirers. My results highlight that international tax rules fundamentally alter acquisition incentives, rather than simply extending domestic evidence to a new setting.

Third, I contribute to the literature on taxes and investment by providing domain-specific evidence on how targeted restrictions on foreign direct investment affect both real and financial reporting outcomes (Lester 2021). Consistent with tax benefits being capitalized into acquisition pricing, I show that U.S. acquirers pay 4 to 5 percent higher prices for foreign targets in TSA transactions prior to the reform, with these differentials disappearing after the law change. Additionally, I document that U.S. firms engaging in affected transactions increase the amount of

foreign earnings designated as PRE, suggesting that the reform increased the effective cost of repatriation and altered firms' financial reporting of foreign income, contributing to the "lockout effect" of foreign earnings (Fritz Foley, Hartzell, Titman, and Twite 2007; Blouin, Krull, and Robinson 2012). Estimating the economic magnitude using the *PRE($)* specification, I find an incremental increase of approximately $174 billion in indefinitely reinvested earnings, corresponding to roughly $61 billion in deferred U.S. tax liability (assuming a 35% corporate tax rate and no foreign tax credits).

Finally, this study provides timely policy-relevant evidence on the effects of targeted international tax reforms framed as loophole closures. By isolating a specific limitation within the FTC regime, I demonstrate how restricting FTC hyping opportunities can influence foreign direct investment and weaken U.S. firms' competitiveness in foreign M&A markets. My results complement Bird, Edwards, and Shevlin (2017), who show that the U.S. worldwide tax system disadvantages U.S. firms in domestic M&A markets; I show that FTC hyping can offset this disadvantage in foreign M&A markets, but FTC limitations can similarly hinder outbound foreign acquisitions and change financial reporting decisions. This evidence is especially relevant as U.S. tax policy moves away from capital export neutrality and towards policies that differentially favor domestic economic activity (The White House 2025a, b, c). The remainder of the paper proceeds as follows. In Section 2, I provide background detail and in Section 3 I develop my hypotheses. Section 4 describes the research design, Section 5 discusses the results and Section 6 concludes.

CHAPTER II

BACKGROUND

This section provides background information on (1) the taxation and accounting of foreign direct investment, (2) M&A structuring (including stock acquisitions treated as asset acquisitions), (3) cross-border M&A, and (4) the enactment of the 2010 Act.

2.1. Taxation and Accounting of Foreign Direct Investment

2.1.1. U.S. Taxation of Foreign Direct Investment

Prior to 2018, the United States taxes U.S. corporations on their worldwide income and provides a tax credit for foreign taxes paid. Foreign subsidiary income is not taxed until the earnings are repatriated, with exceptions for passive or mobile types of income that are subject to U.S. tax when earned. U.S. corporate taxpayers may claim FTCs for taxes paid by foreign subsidiaries to avoid double taxation.[7]

This underlying international tax policy approach has remained in force for over 100 years—the Revenue Act of 1921 formalized foreign subsidiary earnings deferral, the Revenue Act of 1918 introduced the foreign tax credit, and the Revenue Act of 1913 established the corporate income tax on worldwide income following the ratification of the sixteenth amendment to the Constitution.[8] In 2017, Congress enacted major international tax reform affecting the taxation of foreign direct investment. Most significantly, the law began exempting certain active

[7] §§ 901, 902, 951, 960. The passive or mobile income is treated as a deemed dividend from the foreign subsidiary earning the income, up the chain of ownership, to the U.S. shareholder(s).

[8] Pub. L. No. 67-98, 42 Stat. 227; Pub. L. No. 65-254, 40 Stat. 1057; Pub. L. No. 63-16, 38 Stat. 114; U.S. Const. amend. XVI, respectively.

foreign earnings from U.S. tax through a 100% dividend-received deduction, moving the U.S. from a worldwide to a quasi-territorial tax system.[9] As an offset, the law introduces a new type of foreign income, global intangible low-taxed income, that is subject to U.S. tax when earned.[10] Foreign subsidiary earnings that are deemed passive or mobile income, as well as foreign earnings earned directly by U.S. companies (*i.e.*, unincorporated affiliate income), remain subject to immediate U.S. taxation, with a credit for foreign taxes paid.

2.1.2. Accounting for Foreign Direct Investment

Under U.S. GAAP, companies consolidate the financial results of their foreign subsidiaries into their financial statements.[11] U.S. GAAP presumes that foreign subsidiary earnings will be repatriated to the U.S. parent and generally requires companies to recognize deferred tax liabilities—and income tax expense—on the estimated repatriation tax cost.[12] However, such recognition may be avoided if the firm asserts that the earnings will be permanently reinvested abroad (PRE).[13] The assertion must be supported by plans to use the earnings in foreign operations with sufficient evidence to demonstrate that repatriation is not foreseeable. The availability of FTCs directly affects the expected repatriation tax cost. When

[9] §245A.

[10] §951A. Global intangible low-taxed income is the amount of foreign subsidiary earnings in excess of 10% of tangible depreciable assets used to generate those earnings, determined annually for each U.S. shareholder. The U.S. effective tax rate on global intangible low-taxed income is reduced by a related deduction in §250. The One Big Beautiful Bill Act alters these rules, *e.g.*, changing "global intangible low-tax income" to "net CFC tested income", adjusting the deduction calculation in §250, but the move towards capital import neutrality is maintained (§245A).

[11] Accounting Standards Codification 810-10-15-8.

[12] Accounting Standards Codification 740-30-25-3 and 740-10-25-2.

[13] Accounting Standards Codification 740-30-25-17.

FTCs are abundant, the residual U.S. tax may be minimal, reducing the incentive to assert PRE. When FTCs are limited or unavailable, firms may be more likely to designate earnings as permanently reinvested to avoid income tax expense recognition on more costly repatriation structures.

The PRE accounting treatment can significantly reduce reported tax expense and effective tax rates, creating incentives to assert indefinite reinvestment when the tax cost of repatriation is high or rising (Krull 2004). Krull (2004) provides early empirical evidence that firms use PRE designations to strategically manage earnings, finding firms with the greatest ability to manage earnings with PRE, report PRE amounts positively related to the difference between earnings forecasts and pre-managed earnings (reported earnings minus the change in taxes on PRE). Further, she finds that PRE is positively associated with the difference between foreign and domestic after-tax returns and negatively associated with the tax benefits of deductible payments made to the U.S. parent. These patterns suggest that firms weigh the cost of repatriation when deciding whether to assert PRE, and that PRE designations are used, at least in part, to influence reported earnings.

Subsequent work by Blouin *et al.* (2012) links PRE to broader firm behavior. They show that the financial reporting benefits of PRE reduce firms' incentives to repatriate earnings, contributing to the buildup of cash abroad. In follow-up work, Blouin, Krull, and Robinson (2019) further show that PRE assertions reflect both tax and investment incentives; in Blouin *et al.* (2025) they find that firms with more PRE held in cash repatriate more earnings and exhibit greater reductions in internal capital market frictions, in response to the U.S. implementing quasi-territoriality in 2017.

Taken together, this literature demonstrates that PRE is not merely a mechanical accounting classification. Rather, it reflects how firms manage the financial reporting effects of tax costs and internal frictions associated with foreign earnings—particularly when the repatriation tax cost is salient.

2.2. Mergers & Acquisitions Structuring

When one company acquires another, the transaction can be structured in several ways, but generally either as an asset acquisition or a stock acquisition, and either as a taxable or tax-*deferred* transaction. Structural choices carry important legal, operational, and tax consequences.

In a taxable asset acquisition, the buyer purchases specific assets from the target and assumes associated liabilities, excluding the target's other assets, liabilities, and legal and tax attributes. The target recognizes gain or loss on the sale of its assets with sale proceeds remaining in the target, so any subsequent dividend or liquidating distribution to shareholders creates a second taxable transaction. Asset acquisitions typically provide a step-up in the tax basis of the acquired assets to their fair market value, increasing annual depreciation and amortization deductions, and reducing future tax liabilities for the acquired firm. Prior work shows that increasing future depreciation and amortization deductions provides substantial tax benefits; Kaplan (1989) and Schipper and Smith (1991) were the first to link enhanced depreciation deductions to acquisition value, studying management buyouts in the 1980s.

In a taxable stock acquisition, the buyer acquires the target's shares directly from its shareholders and assumes ownership of the legal entity. Thus, only shareholders recognize gain or loss on their share disposition. In contrast to a taxable asset acquisition, stock acquisitions generally preserve the target's historic asset basis for tax purposes, with the buyer taking a fair

market value tax basis in the acquired stock. Additionally, stock acquisitions may allow the buyer to retain legal and tax attributes—such as tax loss carryforwards or key contractual relationships with suppliers, customers, employees, and/or regulators. These attributes can be valuable and influence firms' acquisition behavior. Bührule *et al.* (2023) study both tightening and loosing of post-acquisition limitations on the use of tax loss carryforwards, finding tightening (loosening) loss limitation rules dampen (expand) M&A activity.

In tax-deferred transactions, the tax basis of the assets or securities given or received carries over from the assets or securities exchanged, deferring built-in gain or loss recognition until future disposal. My discussion focuses on taxable acquisition structures because the FTC hyping Congress intended to prevent in the 2010 Act—covered asset acquisitions—arise in taxable transactions.

2.2.1. Taxable Stock Acquisitions Treated as Asset Acquisitions

To provide tax neutrality between the acquisition of assets (which results in a step-up in tax basis) or shares (which results in no step-up), the U.S. allows an acquirer to elect to treat a qualified stock purchase as an asset purchase for U.S. tax purposes (§338 election).[14] Under this election, the target is deemed to have sold all its assets to a new target in a single transaction at the close of the acquisition date, resulting in a tax on any gain from the deemed sale and the acquirer taking a fair market value tax basis in both the target's shares and assets.[15] Erickson and

[14] §338(d)(3), a qualified stock purchase means any transaction, or series of transactions, in which stock (representing 80 percent of the vote and value) of one corporation is acquired by another corporation, by purchase, during a 12-month acquisition period.

[15] §338(a). The tax consequences of the election depend on the transaction structure. Under §338(g), the target is treated as selling its assets realizing gain at the corporate level—this corporate-level tax liability offsets the benefit of the asset basis step-up. In contrast, an alternative election under §338(h)(10) treats the transaction as a sale of

Wang (2000, 2007) show that in situations where asset basis step-ups generate net tax benefits, those benefits are partially shared with sellers through higher acquisition premiums.[16] These results demonstrate the value of stepping up the tax basis in acquired assets, which can influence the acquirer's negotiated purchase price and after-tax return.

2.2.2. Taxable Stock Acquisition of a Foreign Target by U.S. Acquirer

In a taxable stock acquisition of a foreign corporation, a U.S. acquirer can still elect to treat a qualifying stock purchase as an asset acquisition using a §338 election. However, in the case of a foreign target, if the foreign target's assets are not effectively connected with a U.S. trade or business, the deemed asset sale resulting from the §338 election does not create taxable gain or loss at the target corporation level—for foreign or U.S. tax purposes.[17] Instead, the U.S. acquirer takes a fair market value basis in the acquired assets for U.S. tax purposes and the deemed sale is ignored for foreign tax purposes. The asset basis difference results in increased depreciation and amortization deductions for U.S. tax purposes.

As a result of the transaction, the U.S. tax base (foreign income taxable in the U.S.) is lower than the unaffected foreign tax base (foreign income taxable in the foreign country); thus, the taxes paid by the target as a percentage of the U.S. tax base is "hyped". For instance, if the acquired foreign target earned $10 million of income subject to a 25% foreign tax rate, and its

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assets by the target's shareholders avoiding gain or loss on the shares sold. As a result, the gain is taxed only once at the shareholder level; however, §338(h)(10) elections are limited to certain subsidiary sales.

[16] Erickson and Wang use settings in which the deemed asset sale does not result in an additional layer of corporate-level tax (*i.e.*, §338(h)(10) transactions in their 2000 paper and elections made with respect to acquisitions of S corporations in their 2007 follow up).

[17] §§11(d); 882(a). Also see IRS, Chief Counsel Advice Memorandum 2007-006.

assets with a remaining useful life of 10 years were stepped-up from $50 million to $100 million for U.S. tax purposes, the additional depreciation deductions available for U.S. tax purposes equal $5 million each year ($50 million/10 years). Therefore, instead of a foreign effective tax rate of 25% (foreign taxes paid on its foreign tax base), the foreign effective tax rate is 50% (foreign taxes paid of $2.5 million *i.e.*, $10 million * 0.25%, divided by the U.S. tax base of $5 million *i.e.*, $10 million of income less $5 million in additional depreciation deductions). Therefore, foreign taxes paid by the foreign target could offset the U.S. tax on its foreign income *and* the U.S. tax on other, unrelated foreign income of the acquirer.

U.S. acquirers can achieve the same tax result that a §338 election provides on a taxable stock acquisition of a foreign corporation by instead making an entity classification election contemporaneously with the taxable stock acquisition. Since 1997, the U.S. allows taxpayers to affirmatively elect the entity tax classification of eligible entities for U.S. income tax purposes.[18] If a corporation elects to be treated as disregarded separate from its owner, it is treated as distributing all its assets in liquidation just prior to the election date. Thus, if a U.S. firm acquires an eligible foreign corporation and makes an entity classification election to disregard the foreign target, the target is treated as having liquidated just prior to the acquisition, with the U.S. firm treated as acquiring the target's assets (resulting in a tax basis step-up). Again, the election and deemed liquidation are ignored for foreign tax purposes allowing for FTC hyping.[19]

[18] The U.S. entity classification rules under Treasury Regulation Sections (Treas. Reg. §§) 301.7701-2 and -3 allow certain foreign eligible entities to elect their classification for U.S. federal tax purposes.

[19] Unlike a §338 election, the entity classification election under Treas. Reg. §301.7701-3 does not require coordination with the seller or satisfaction of holding thresholds. Instead, it is available to eligible entities that are not *per se* corporations under Treas. Reg. §301.7701-2(b). Eligible entities make the election on IRS Form 8832, *Entity Classification Election*. Additionally, if the foreign target is not an eligible entity type, depending on the foreign jurisdiction, it may be possible to convert the entity type from a *per se* corporation to an eligible entity and then make an entity election. In most instances the foreign country conversion should not create additional U.S. tax consequences (*see* §368(a)(1)(F)).

2.3. Cross-border Mergers & Acquisitions

Firms engage in foreign direct investment (often through cross-border M&A) to access new markets, reduce production costs, and protect proprietary technologies through internalized global operations (Dunning 1980). Empirical literature investigates the relationship between corporate tax rates and investment behavior, including firms' decisions to engage in cross-border M&A. Early work by Hines (1996) examines foreign direct investment by foreign firms into the U.S. and finds that higher U.S. state tax rates are associated with lower inbound foreign investment, even from countries that offer foreign tax credits. This result suggests that tax differentials can distort location decisions, undermining the capital export neutrality objective intended by an FTC system (Shaviro 2010). More recently, Arulampalam *et al.* (2019) show that higher corporate tax rates reduce the probability that a firm is acquired, reinforcing the deterrent effect host-country tax burdens have on cross-border M&A.

Other elements of the tax system also influence foreign direct investment. Huizinga and Voget (2009) and Feld *et al.* (2016) compare the effect of worldwide taxation and territoriality on M&A activity. Huizinga and Voget (2009) show that firms from worldwide taxation countries are less likely to be the post-merger parent in a cross-border M&A. They estimate a 5% increase in the likelihood of parent firms locating in the U.S. if the U.S. were to eliminate worldwide taxation. Feld *et al.* (2016) find an increase in outbound M&A following the abolishment of repatriation taxes in Japan, the United Kingdom, and New Zealand in 2009. They estimate that a similar policy switch in the U.S. would increase the number of cross-border acquisitions by U.S. firms by 11%. Despite these estimates, Amberger and Robinson (2024) find a significant decline in outbound M&A by U.S. firms following the introduction of quasi-territoriality in the U.S. However, the U.S. implementation of territoriality fell short of the suggestions in Huizinga and

Voget (2009) and Feld *et al.* (2016), and the 2017 law also includes a wide array of other tax reform changes. Amberger and Robinson (2024) attribute part of their findings to the introduction of the global intangible low-taxed income regime, which reduces incentives for U.S. firms to acquire profitable low-taxed targets. However, contrary to their main finding, they do find a higher likelihood that U.S. firms with no international presence acquire a foreign target. These empirical results support the notion that multinationals from countries that impose taxes on repatriated profits face a comparative disadvantage in acquiring foreign firms.

Focusing within the U.S. worldwide tax system, Hanlon, Lester, and Verdi (2015) find that U.S. firms with greater foreign cash holdings, induced by repatriation tax costs, are associated with a higher likelihood of completing a foreign acquisition. However, they also find a negative association between the tax-induced foreign cash holdings and the market reaction to these foreign deals, concluding that these transactions are perceived as less-value enhancing. Edwards *et al.* (2016) further show that firms with "trapped cash" due to repatriation tax costs make less profitable foreign acquisitions (*i.e.*, those acquisitions are associated with lower announcement window returns, lower buy and hold returns, and decreased return on assets). These studies show how tax-induced distortions in cash holdings influence both the location and quality of cross-border M&A.

More recent work explores how targeted tax provisions affect M&A. Bradley *et al.* (2021) show that innovation tax incentives stimulate M&A activity in the enacting country, but the stringency of the country's nexus requirements to claim the innovation tax benefits moderates the effect. Blouin *et al.* (2021) find that U.S. firms benefiting from a new deduction—the domestic production activities deduction—increased acquisition activity, both in the U.S. and abroad. These studies provide empirical evidence that even narrowly targeted tax provisions can

meaningfully influence firms' acquisition behavior, reinforcing the broader link between tax policy and cross-border M&A.

2.4. Education, Jobs, and Medicaid Assistance Act of 2010

The Education, Jobs, and Medicaid Assistance Act of 2010 provided emergency funding to U.S. states following the global financial crisis, aiming to prevent teacher layoffs and support Medicaid services. Although not a tax-focused bill, the international tax provisions offset the bill by limiting FTC hyping. The tax provisions are estimated to raise between $10 and $11 billion over the 10-year budget window (The Joint Committee on Taxation 2011). Two provisions account for most of the estimate: disallowing FTCs arising from covered asset acquisitions (described above) and suspending FTCs when the foreign earnings to which they relate are "split" across entities or time.[20]

Taxpayers completing CAAs—acquisitions treated as asset purchases for U.S. tax purposes but stock purchases (or disregarded) for foreign purposes—must now calculate a "disqualified portion" of FTCs each year, based on mismatches between the U.S. and foreign tax basis in the acquired assets. The disqualification limits FTCs to those attributable to the foreign tax base, thereby reducing the benefit of stepping up the tax basis in the acquired assets for U.S. tax purposes. Continuing with the example above, a proportion of the $2.5 million in foreign taxes paid—$1.25 million based on these facts[21]—is disallowed as FTCs after the law change.

[20] §909.

[21] The disqualified portion is the lesser of the foreign taxes paid (*i.e.*, $2.5 million) or the tentative disqualified tax amount of $1.25 million (foreign income tax amount * (aggregate basis difference)/(allocable foreign income) *i.e.*, $2.5 million * $5 million/$10 million). This calculation is to be made each year based on current information.

Thus, the foreign target's effective tax rate returns to 25% by decreasing the numerator in the effective tax rate ratio (foreign taxes paid/U.S. tax base on foreign earnings, *i.e.,* [*(*$2.5 million – $1.25 million)/$5 million]). Congress nonetheless allows companies to deduct (as opposed to credit) disallowed FTCs leaving some tax benefits resulting from CAA transactions.[22] *See* Appendix A for a detailed example.

The splitter rule delays FTC use until the corresponding foreign income is included in U.S. taxable income. Previously, firms could use hybrid instruments, hybrid entities, or tax-deferred reorganizations to claim FTCs while deferring the related income. Although not limited to M&A, these structures were frequently used to finance cross-border acquisitions.

The 2010 Act was originally introduced in the House on March 18, 2009, as the "FAA Air Transportation Modernization and Safety Improvement Act," but was dramatically amended by the Senate on August 5, 2010, where the international tax reforms were added. The House passed the amended bill shortly thereafter, and President Obama signed it into law on August 10 leaving firms little time to respond. President Obama characterized the international provisions as closing "tax loopholes that encourage corporations to ship American jobs overseas," rather than fundamentally altering the structure of U.S. international tax law (Obama 2010, para. 4).

[22] §901(m)(6).

CHAPTER III

HYPOTHESIS DEVELOPMENT

Economic theory has long recognized the role of taxation in shaping corporate investment behavior. In seminal work, Jorgenson (1963) and Hall and Jorgenson (1967) demonstrate that taxes influence investment by affecting the user cost-of-capital and the after-tax return on the investment. Lower tax rates reduce the cost-of-capital, raise after-tax cash flows, and increase the marginal return to investment, encouraging firms to invest additional capital. This framework predicts that firms invest more when tax burdens are low and invest less as taxes increase. Although originally developed to explain physical capital investment (*e.g.*, equipment purchases, facility expansions), the economic logic extends to a broad range of corporate investments, including research and development, intangible capital, and mergers and acquisitions. In each case, taxation affects the expected return on investment and may influence the timing, scale, and structure of firms' investment choices.

3.1. Domestic Taxable Acquisitions

In the case of M&A, Erickson and Wang (2007) summarize three taxable acquisition structures for the purchase of a U.S. C corporation:

(1) a taxable asset acquisition,

(2) a taxable stock acquisition followed by a §338 election, and

(3) a taxable stock acquisition that is not followed by a §338 election.

Structures 1 and 2—effectively taxable asset purchases—result in two layers of tax: one at the target corporation level and one at the shareholder level. Taxable gain or loss recognized by the target equals the difference between the target's asset basis and the sales price. Taxable gain or

loss recognized by target shareholders equals the difference between their stock basis and either the after-tax sales proceeds received in liquidation (Structure 1) or the sales price (Structure 2). Structure 3 differs in that it eliminates the taxable gain at the target corporation level and the target's tax attributes may survive. Table 1 details major tax consequences of each structure for the target, the acquirer, and the target's shareholders.

Structure 3 avoids taxable gain at the target corporation level, but buyers may be willing to pay more in Structures 1 or 2 to obtain valuable tax benefits from stepping up the tax basis in assets to their fair market value (Kaplan 1989; Schipper and Smith 1991; Erickson and Wang 2000, 2007). As described in Appendix B, Erickson and Wang (2007) derive the price at which a seller is indifferent between the transaction structures and compare it to the maximum price the acquirer should be willing to pay in a taxable asset purchase. They conclude the acquirer's maximum price is likely less than the seller's indifference price when discount rates are greater than zero and tax rates are constant, leading many U.S. acquirers to structure taxable acquisitions of C corporations as 'stock deals with no §338 election' rather than asset purchases. However, they limit their analysis to U.S. targets. When the analysis is extended to taxable acquisition structures involving foreign target corporations, the incentives change.

3.2. Foreign Taxable Acquisitions

In the case of the acquisition of a foreign target, four taxable acquisition structures exist:

(1) a taxable asset acquisition,

(2) a taxable stock acquisition followed by a §338 election,

(3) a taxable stock acquisition that is not followed by a §338 election, and

TABLE 1
Major Tax Consequences of Various Taxable Acquisition Structures

	U.S. C Corporate Target			Foreign Corporate Target			
		Stock Acquisition			Stock Acquisition		
Structural or Tax Issue	Asset Acquisition[a]	With §338 Election[b]	Without §338 Election[c]	Asset Acquisition[a]	With §338 Election[d]	Without §338 Election[c]	With CTB Election[e]
Taxable Gain at the Target Corporation Level	Yes	Yes	No	No	No	No	No
Taxable Gain Recognized by Target Shareholders	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Nature of Target Shareholder Gain	Capital Gain	Capital Gain	Capital Gain	Capital Gain	Capital Gain	Capital Gain	Capital Gain
Step-Up in the Tax Basis of Target's Assets	Yes	Yes	No	Yes	Yes	Yes	Yes
Target's Tax Attributes Survive (Foreign, U.S.)	No	No	Yes	No, No	Yes, No	Yes, Yes	Yes, No

[a] Target corporation sells its assets to the acquirer for cash, pays any resulting tax (or receives a tax refund) on the gain (loss) recognized, and distributes the after-tax proceeds of the asset sale to its shareholders in redemption of all their target stock. The target's stock is then cancelled, and the target corporation vanishes.
[b] Target corporation shareholders receive cash from the acquiring firm in return for their target corporation shares. The acquiring corporation makes a §338 election, which results in a deemed sale of the target's assets to a new target company. This deemed sale results in a step-up in the tax basis in the target's assets.
[c] Target corporation shareholders sell their stock to the acquirer, but the acquirer does not make a §338 election. There is no step-up in the tax basis of the target's assets; the acquirer takes a carryover basis in the target's assets.
[d] Target corporation shareholders receive cash from the acquiring firm in return for their target corporation shares. The acquiring corporation makes a §338 election, which results in a deemed sale of the target's assets to a new target company. This deemed sale results in a step-up in the tax basis in the target's assets, but no taxable gain (loss) is recognized for U.S. or foreign tax purposes.
[e] Target corporation shareholders receive cash from the acquiring firm in return for their target corporation shares. The acquiring corporation makes an entity classification election on IRS Form 8832 to disregard the foreign target from its owner for U.S. income tax purposes, which results in a deemed liquidation of the target's assets to its shareholders on the day before the election such that the acquisition is treated as the acquisition of the target's assets. This deemed asset sale results in a step-up in the tax basis in the target's assets for U.S. tax purposes.

(4) a taxable stock acquisition followed by an election to disregard the foreign target as separate from its owner for U.S. income tax purposes (CTB election).[23]

Structures 1 and 3 produce the same tax consequences in acquisitions of foreign targets and U.S. targets, albeit the tax rates will vary between jurisdictions. The tax consequences in Structures 2 and 4 differ when the target is foreign rather than domestic. If the foreign target's assets are not effectively connected with a U.S. trade or business, then there is no taxable gain or loss at the target corporation level for the deemed asset sale that takes place in Structures 2 and 4—for foreign or U.S. tax purposes.[24] Nevertheless, a U.S. acquirer still achieves a step up in the tax basis of the target's assets and the incremental depreciation/amortization deductions hype the target's post-acquisition FTCs. Table 1 describes these four foreign target acquisition structures and their tax consequences.

Given that the tax outcomes in Structures 2 and 4 are treated the same, I analyze them together (assuming a §338 election) and compare scenarios in which the target is U.S. versus foreign. The maximum purchase price a U.S. acquirer is willing to pay in a taxable stock acquisition with a §338 election for a U.S. target ($MXP_{U.S.338}$) and a foreign target (MXP_{For338}) yields the following equations:

[23] Treas. Reg. §§301.7701-2 and -3; IRS Form 8832, *Entity Classification Election*. CTB stands for "check-the-box" because on Form 8832 the election is made by checking a box. While Structures 2 and 4 produce the same tax consequences, the eligibility requirements are different—the foreign target does not have to be acquired in a "qualified stock purchase" but instead must be an eligible entity and make an entity classification election effective on the date of the acquisition.

[24] §§11(d), 882(a); IRS Chief Counsel Advice Memorandum 2007-006.

$$MXP_{U.S.338} = P_{stk} + \left\{\left[(P_{stk} - ASB) * \frac{d}{N}\right] * PV_s * t_c\right\} - [(P_{stk} - ASB - ATT) * t_c] - (P_{stk} * r * PV_a * t_c), \quad (1)$$

$$MXP_{For338} = P_{stk} + \left\{\left[(P_{stk} - ASB) * \frac{d}{N}\right] * PV_s * t_c\right\} + \left(PV_a * t_{c(For)} * ATT_{For}\right) - (ATT * t_c * PV_a), \quad (2)$$

where P_{stk} is price paid to target shareholders in a taxable stock purchase, *ASB* is the target's pre-acquisition net tax basis in its assets, *d* is the percentage of the step-up in basis that is attributable to depreciable or amortizable assets, *N* is the period over which the step-up will be depreciated/amortized on a straight-line basis, PV_s is the present value of an *n* period annuity, t_c is the U.S. corporate tax rate and $t_{c(For)}$ is the foreign corporate tax rate, *ATT* represents the target's U.S. tax attributes, *r* is the long-term tax-exempt rate set by the government, PV_a is the present value of an annuity for the tax attributes preserved after a taxable stock purchase, and ATT_{For} represents the target's foreign tax attributes determined under foreign law.

In Eq. (1), the U.S. acquirer's maximum price is the price for the shares in a taxable stock acquisition without a §338 election, plus the present value of the tax benefits from the asset basis step-up, less the corporate-level tax from the deemed asset sale, less the present value of the target's extinguished U.S. tax attributes. The additive second term is the amount by which the price exceeds the net tax basis in the assets (the step-up), multiplied by the percentage of depreciable/amortizable assets, divided by the depreciation/amortization period. This per-year benefit is then discounted back to the acquisition period and tax effected. The negative third term is the corporate tax from the deemed asset transaction considering the target's tax basis in assets

and tax attributes (*e.g.*, net operating loss carryforwards).[25] The fourth negative term is the discounted and tax effected amount of the target's tax attributes available to offset post-acquisition income.[26]

In Eq. (2), the present value of the tax benefits from stepping up the tax basis in the target's assets is the same for the acquisition of a U.S. or foreign target—the acquirer benefits from increased depreciation/amortization deductions based on the U.S. corporate tax rate.[27] However, the value of the foreign target's foreign tax attributes is added, with the model assuming calculations and any local limitations are embedded in ATT_{For}. The corporate-level tax from the deemed asset sale is removed because the §338 election does not create a taxable gain or loss if the foreign target's assets are not effectively connected with a U.S. trade or business. A reduction for loss of the target's U.S. tax attributes remains as the negative fourth term but may be zero where the *foreign* target does not have any *U.S.* tax attributes.[28]

Following Erickson and Wang (2007), I set Eqs. (1) and (2) equal revealing an inequality; for a general taxable stock acquisition for a U.S. acquirer, Eq. (2) is always greater than Eq. (1):

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[25] This model ignores state income tax and target shareholder tax attributes (*e.g.*, capital loss carryforwards); it also assumes maximum individual and corporate tax rates. Further, Erickson and Wang (2007) draw equivalence between a taxable asset acquisition of the target and a taxable stock acquisition followed by a §338 election stating that tax consequences between the two are the same for the target shareholders. While the total tax between the three parties (acquirer, target, and target shareholders) is equivalent, the target level tax in a §338 election (as opposed to a taxable asset acquisition) is borne by the target corporation after the acquisition and thus reduces the acquirer's, not the target shareholder's, welfare as modeled here (§338(a)(2)).

[26] This model construction is meant to mimic tax attribute limitations in §§382, 383, and 384.

[27] Post §901(m), the value of the step-up benefits for a foreign target decrease, but not to zero. Not only do U.S. acquirers still get to deduct foreign taxes paid, and not recognize U.S. tax on deducted foreign taxes, the specific application of the rules can also produce varying benefits depending on the earnings and taxes paid by the foreign target in any given year.

[28] In many instances, eliminating any U.S. tax attributes in the foreign target is a benefit to the U.S. acquirer: avoiding reconstruction of tax records, freedom to change from prior tax elections, accounting methods, and/or taxable year(s).

$$-[(P_{stk} - ASB - ATT) * t_c] - (P_{stk} * r * PV_a * t_c) < (PV_a * t_{c(For)} * ATT_{For}) \quad (3).$$

In Eq. (3) both left-hand side terms (corporate-level tax on the deemed asset sale and present value of the elimination of U.S. tax attributes) are negative. The right-hand side is positive; the present value and tax effected foreign tax attributes determined under foreign law that remain after a taxable stock acquisition. The reduction for the loss of the target's U.S. tax attributes is assumed to be zero or negative, further increasing the inequality, and left out of Eq (3).

Unlike the sellers in Erickson and Wang (2007), non-U.S. sellers should be indifferent as to whether U.S. acquirers make a §338 election or not following a taxable stock acquisition of a foreign target. Comparing instead the maximum price a U.S. acquirer will pay for the acquisition of a foreign target followed by §338 election with the maximum price it will pay for a taxable stock acquisition without a §338 election (MXP_{stk}, which equals P_{stk}) reveals a theoretical price premium for the acquisition of a foreign target followed by §338 election equal to the present value of the tax benefits from stepping up the tax basis in the target's assets:

$$MXP_{For338} - MXP_{stk} = \left[(P_{stk} - ASB) * \frac{d}{N}\right] * PV_s * t_c \quad (4).^{29}$$

3.3. U.S. Acquirers' Taxable Stock Acquisition of Foreign Target Preference

Eq. (3) demonstrates greater after-tax, post-acquisition cash flows associated with a taxable stock purchase followed by a §338 election for a foreign, relative to a domestic, target.

[29] If the comparison was instead the acquisition of a foreign target followed by §338 election to a taxable stock acquisition without a §338 election of a domestic target, the difference in the present values of the tax attributes for domestic and foreign tax purposes would need to be considered.

Similarly, Eq. (4) shows the additional benefit U.S. acquirers can generate by making a §338 election following a taxable stock purchase of a foreign target. Thus, U.S. firms are incentivized to use taxable stock acquisitions for the purchase of foreign targets over domestic targets to obtain a tax-free step-up in the tax basis of the target's assets enabling FTC hyping *and* to preserve the target's foreign tax attributes. For a given price, the after-tax return for a foreign target in a TSA is greater than for a domestic target. U.S. acquirers may share these tax benefits with foreign sellers offering higher prices to induce sales.

Hypothesis 1A: U.S. acquirers are more likely to structure acquisitions of foreign targets, relative to U.S. targets, as taxable stock acquisitions.

Hypothesis 1B: U.S. acquirers pay higher acquisition prices for foreign targets in taxable stock acquisitions, relative to foreign acquirers and alternative acquisition structures.

3.4. Covered Asset Acquisitions following the 2010 Act

By disallowing FTCs attributable to asset basis differences in CAAs, the 2010 Act eliminates the primary tax benefit from stepping up the tax basis in a foreign target's assets to their fair market value. The 2010 Act—§901(m)—increases the expected U.S. tax cost on future repatriations and reduces the after-tax return from cross-border M&A transactions that previously benefited from FTC hyping. According to standard investment theory, higher taxes increase the cost of capital and lower the marginal return on investment, discouraging firms from deploying capital (Jorgenson 1963; Hall and Jorgenson 1967). Consistent with this view, empirical studies show that M&A activity responds to changes in tax incentives (Hines 1996;

Erickson and Wang 2000; Bühruleet *al.* 2023). If firms price deals based on expected after-tax returns, then the loss of FTC hyping benefits should reduce the likelihood of pursuing these structures in transactions and may lower the price they are willing to pay.

However, several considerations complicate this prediction. First, Hanlon *et al.* (2015) show that high repatriation tax costs are associated with increased foreign acquisition activity, as firms reinvest trapped earnings abroad rather than return cash to the U.S. Second, repatriation tax costs related to CAAs are deferred until future distributions occur, leading firms to potentially discount the disallowed credit at the time of acquisition. Third, firms may use CAAs for reasons unrelated to FTC planning.[30] Fourth, even when foreign taxes are disallowed as credits, firms can still deduct them, preserving some benefit.[31] Fifth, some firms may remain insensitive to the tax change due to strategic motives or preexisting commitments. Sixth, the acquisition structure is ultimately determined in concert with the seller. Thus, their preferences may control the structure of the acquirer's foreign direct investment decision. Finally, budget estimates projected that the tax provisions in the 2010 law would raise a modest $10-11 billion—compared to, for example, the over $112 billion in projected revenue from the global intangible low-taxed income provision enacted in the 2017 reform (Joint Committee on Taxation 2011, 2017). This contrast underscores the relatively narrow scope of the 2010 policy change and supports the interpretation that it serves primarily as a targeted loophole closure, rather than a sweeping overhaul of foreign direct investment tax incentives. Given these countervailing considerations, I state my hypotheses in the null.

[30] For example, to eliminate unfavorable tax attributes like a passive foreign investment company taint or reset the target's taxable year §1297, Treas. Reg. §1-338-1(b)(1)(ii).

[31] §901(m)(6).

Hypothesis 2A: Following the 2010 Act, U.S. acquirers are no more or less likely than foreign acquirers to structure cross-border M&A transactions as taxable stock acquisitions.

Hypothesis 2B: Following the 2010 Act, U.S. acquirers do not pay higher acquisition prices for cross-border taxable stock acquisitions relative to foreign acquirers and alternative acquisition structures.

3.5. Repatriation Tax Costs Shaping Foreign Earnings Financial Reporting

Designating foreign earnings as permanently reinvested avoids the recognition of tax expense (and the related deferred tax liability) associated with its repatriation. If U.S. firms respond to higher repatriation tax costs by asserting PRE, then eliminating FTC hyping opportunities, which increase the residual cost of repatriation, should increase the disclosure of indefinite reinvestment in financial statements. In this setting, U.S. firms completing CAAs may place greater value on the PRE designation, as it allows them to defer—or altogether avoid—recognizing the higher tax expense associated with future repatriations. This logic aligns with prior work showing that PRE designations respond to repatriation tax incentives. For example, Krull (2004) finds that firms weigh the tax cost of bringing earnings home when determining whether to assert PRE. Similarly, Blouin *et al.* (2019) demonstrate that PRE reflects both tax and investment incentives, and Blouin *et al.* (2025) document that following the Tax Cuts and Jobs Act, firms with more PRE held in cash, respond by repatriating more earnings and exhibiting greater reductions in internal capital market frictions. These insights suggest that firms completing targeted CAAs have stronger incentives to designate those earnings as permanently reinvested to delay or avoid recognizing the financial reporting expense and liability.

Several reasons may attenuate the extent to which acquisitive firms increase PRE designations following the 2010 law change. Firms may have already classified most of their foreign earnings as permanently reinvested, leaving little room for further increases. Others may base their PRE decisions strictly on reinvestment intentions and growth opportunities unrelated to financial reporting outcomes. Some firms anticipating the rule's effective date may have accelerated repatriations, temporarily reducing the earnings available to designate as PRE. In addition, Blouin *et al.* (2019) suggest that PRE can also reflect financial constraints or signaling behavior, not just tax motives. If PRE designations respond to a mix of investment incentives, internal capital frictions, and financial reporting goals, then the effect of tax law changes—targeting FTC hyping—may be diluted or difficult to detect in PRE reporting. Given these competing incentives and constraints, I state my hypothesis in the null:

Hypothesis 3: Following the 2010 Act, U.S. multinationals completing cross-border taxable stock acquisitions do not change their designation of foreign earnings as indefinitely reinvested relative to other U.S. multinationals.

CHAPTER IV

RESEARCH DESIGN

I test the paper's three hypotheses using a series of transaction- and firm-level regressions. The first focuses on pre-reform acquisition preferences. The second introduces a natural experiment and difference-in-difference design to test how the 2010 Act affects U.S. acquirers' use and pricing of covered asset acquisitions. Finally, the third continues with the natural experiment to examine whether U.S. firms changed their financial reporting of foreign earnings following targeted acquisitions after the 2010 Act.

4.1. Pre-Reform Acquisition Preferences

To test Hypothesis 1A—prior to 2011, U.S. acquirers are more likely to structure acquisitions of foreign targets, relative to U.S. targets, as taxable stock acquisitions—I estimate a series of regression equations using a sample of M&A transactions completed by U.S. acquirers from 2000 to 2010, prior to the effective date of the 2010 Act. Consistent with Hanlon *et al.* (2015) and Amberger and Robinson (2024), I consider acquirer firm ownership when defining U.S. acquirer. In my study, I classify a transaction as having a U.S. acquirer if either the acquirer, intermediate parent, or ultimate parent is incorporated or headquartered in the United States (*US Acq*). This definition captures any transaction where the acquiring group may benefit from FTC hyping opportunities.

I estimate the following linear probability model using ordinary least squares (OLS)[32]:

[32] Including fixed effects in nonlinear models can cause econometric issues, so I follow Amberger and Robinson (2024) using OLS which is preferable in fixed-effects estimations with a binary dependent variable.

$$TSA_{a,d,t} = \alpha + \lambda_{jt} + \beta_1 Foreign\ Target_d + \sum_k \beta_k CONTROL^k_{a,d,t} + \varepsilon_{a,d,t}, \quad (5)$$

where the unit of observation is an acquirer-deal pair with acquirers indexed by *a*, deals indexed by *d*, and the year when deal *d* is completed indexed by *t*. Eq. (5) estimates the likelihood that a transaction is structured as a taxable stock acquisition. The dependent variable, *TSA*, is an indicator equal to one for taxable stock acquisitions, *i.e.*, where the buyer(s) uses cash or assets to acquire target equity.[33] The key independent variable, *Foreign Target*, is an indicator equal to one if the target firm's country of incorporation is not the United States. A positive coefficient on $\beta_1$would be consistent with a higher probability that U.S. acquirers structure an acquisition as a TSA when the target is foreign.

The regression includes acquirer industry-year fixed effects (λ_{jt}) to ensure that I am comparing treated and control firms operating in the same Fama-French 48 industry classification, while controlling for time-varying macroeconomic factors and merger waves across industries (Fama and French 1997, Brealey and Myers 2003, Heider and Ljungqvist 2015).[34]

I include a vector of control variables (*CONTROL*) comprised of acquirer firm-level accounting fundamentals and M&A transaction characteristics. I measure acquirer fundamentals in the fiscal year prior to the transaction: the natural log of total assets (*Size*), cash (*Cash*), non-

[33] I identify taxable stock acquisitions based on the composition of consideration offered and received in the transaction. Specifically, I classify a deal as a taxable stock acquisition if (a) the consideration received from the seller includes stock or equity instruments (*e.g.*, ordinary shares, common or preferred stock, equity units, or warrants), and (b) the consideration offered by the acquirer includes cash or assets (*e.g.*, cash, debt assumption, promissory notes, or other non-equity property) but not stock or equity instruments. Thus, my empirical measure of TSA is a proxy for actual taxable M&A transactions as the taxability of each transaction is not observable; however, cash acquisitions of shares are taxable transactions in the U.S. and generally elsewhere.

[34] My results are robust to inclusion of acquirer country of incorporation fixed effects.

cash working capital (*WkCap*), leverage (*Leverage*), sales growth (*SalesGr*), and return on assets (*ROA*) (Erickson 1998; Amberger and Robinson 2024; Hanlon *et al.* 2015; Bird *et al.* 2017). Using M&A transaction characteristics, I control for acquisition scale by including the ratio of transaction value to acquirer total assets in the period prior to the acquisition (*Acquisition Size*) and a decile rank of transaction value (*Decile Price*), which capture both the economic significance of the deal to the acquirer and overall transaction size, and allow for nonlinear effects of deal size on transaction structure. I also control for the statutory corporate tax rate in the target country, as prior work demonstrates greater tax rates inhibit acquisitions (*Target Tax Rate*) (Hines 1996; Arulampalam *et al.* 2019; Fox, Krull, Rane 2025).[35] The intercept is α, and error term is $\varepsilon_{a,d,t}$; I cluster standard errors by acquirer name to address correlations in the error term for serial acquirers. In addition, I also use Poisson Pseudo-Maximum Likelihood (PPML) estimation as an alternative specification to account for the binary dependent variable and log transformed total assets which allows for use of high-dimensional fixed effects and clustered standard errors (Silva and Tenreyro 2006). Appendix C provides full variable definitions and sources.

4.2. Pre-Reform Acquisition Pricing

To test Hypothesis 1B—prior to 2011, U.S. acquirers pay higher acquisition prices for foreign targets in taxable stock acquisitions, relative to foreign acquirers and alternative

[35] I thank Fox, Krull, and Rane (2025) for providing worldwide corporate tax rate data. Given that sellers likely face capital gains taxes on share dispositions, controlling for seller-level tax incentives (*e.g.*, capital gains tax rates or seller-country fixed effects) would be desirable. However, the absence of seller information limited my ability to incorporate such controls.

acquisition structures—I estimate a series of OLS models using a sample of M&A transactions completed by U.S. and foreign acquirers over the same pre-reform period as for Eq. (5):

$$Price_{a,d,t} = \alpha + \lambda_{jt} + \beta_1 Foreign\ Target_d + \beta_2 TSA_{a,d,t} + \beta_3 US\ Acq_{a,d,t} + \beta_4 (Foreign\ Target * TSA)_{a,d,t} + \beta_5 (Foreign\ Target * US\ Acq)_{a,d,t} + \beta_6 (TSA * US\ Acq)_{a,d,t} + \boldsymbol{\beta_7} (Foreign\ Target * US\ Acq * TSA)_{a,d,t} + \sum_k \beta_k CONTROL^k_{a,d,t} + \varepsilon_{a,d,t}. \quad (6)$$

Eq. (6) examines acquisition prices across treated and control transactions, where *Price* is measured as either the transaction's total value scaled by the target's implied enterprise value (*Premium*),[36] or the natural log of the total transaction value (*Log(Price)*). All other variables are defined as in Eq. (5), and the unit of observation is acquirer-deal pair, completed in year *t*.[37]

β_1 captures the price difference between non-U.S. and U.S. targets in non-TSA transactions for foreign acquirers. β_2 captures the price difference between TSA and non-TSA transactions involving U.S. targets for foreign acquirers. β_3 captures the price difference between U.S. and foreign acquirers for U.S. targets in non-TSA transactions.

The interaction terms allow these effects to vary across dimensions. β_4 captures the incremental price effect of a TSA when acquiring a non-U.S. target for foreign acquirers. Because foreign acquirers are generally unable to step up the tax basis in the target's assets when using TSAs, β_4 is expected to be non-positive. β_5 captures the incremental effect of a non-U.S.

[36] My results are robust to using total net transaction value (TNTV).

[37] My results are robust to inclusion of acquirer country of incorporation fixed effects.

target for U.S. acquirers in non-TSA transactions. β_6 captures the incremental effect of a TSA for U.S. acquirers for U.S. targets. The coefficient on the triple interaction term (β_7) captures the incremental price paid by U.S. acquirers for non-U.S. targets in taxable stock acquisitions, relative to foreign acquirers and alternative transaction structures. A positive coefficient indicates that acquirers paid higher prices (measured as either *Premium* or *Log(Price)*) in these transactions.

4.3. FTC Hyping Limitations from the 2010 Act

To test Hypotheses 2A and 2B—following the 2010 Act, U.S. acquirers are no more or less likely to structure cross-border M&A transactions as taxable stock acquisitions or to pay higher acquisition prices in such transactions relative to foreign acquirers and alternative acquisition structures—I estimate the following difference-in-differences regressions using a sample of M&A transactions from 2006 to 2015, five years before and after the effective date of the 2010 Act:

$$
\begin{aligned}
TSA_{a,d,t} = {} & \alpha + \lambda_{jt} + \beta_1 US\ Acq_{a,d,t} + \beta_2 Post\ 901(m)_t + \beta_3 XB_{a,d,t} + \\
& \beta_4 (US\ Acq * Post\ 901(m))_{a,d,t} + \beta_5 (US\ Acq * XB)_{a,d,t} + \\
& \beta_6 (XB * Post\ 901(m))_{a,d,t} + \boldsymbol{\beta_7} (US\ Acq * XB * Post\ 901(m))_{a,d,t} + \\
& \textstyle\sum_k \beta_k CONTROL^k_{a,d,t} + \varepsilon_{a,d,t}, \qquad (7)
\end{aligned}
$$

$$Price_{a,d,t} = \alpha + \lambda_{jt} + \beta_1 US\ Acq_{a,d,t} + \beta_2 Post\ 901(m)_t + \beta_3 XB\ TSA_{a,d,t} +$$
$$\beta_4(US\ Acq * Post\ 901(m))_{a,d,t} + \beta_5(XB\ TSA * Post\ 901(m))_{a,d,t} +$$
$$\beta_6(US\ Acq * XB\ TSA)_{a,d,t} + \boldsymbol{\beta_7}(US\ Acq * XB\ TSA * Post\ 901(m))_{a,d,t} +$$
$$\sum_k \beta_k CONTROL^k_{a,d,t} + \varepsilon_{a,d,t}. \quad (8)$$

Like Eq. (5), in Eq. (7) the dependent variable is *TSA*, but I introduce cross-border (*XB*), an indicator equal to one for a cross-border M&A transaction, to distinguish acquisition structures across international and home-country settings. Unlike Eq. (5) that focuses on U.S. acquirers, the difference-in-differences design compares U.S. and foreign acquirers, requiring a symmetric definition of cross-border activity across both groups. Accordingly, I use *XB* rather than *Foreign Target* (which equals one for all non-U.S. targets) to capture whether a transaction involves a cross-border acquisition.

The interaction of *US Acq* and *XB* identifies the subset of transactions that, when structured as taxable stock acquisitions, can generate a tax-free step-up in the tax basis of target's assets for U.S. tax purposes—giving rise to FTC hyping. These transactions therefore define the setting where foreign direct investment disincentives appear, making the interaction a natural empirical proxy for covered asset acquisitions.

The key policy variable, *Post 901(m)*, equals one for transactions completed (or with a definitive agreement) after December 31, 2010, the effective date of the tax law change.

β_1 captures the difference in likelihood that a transaction is structured as a TSA between U.S. and foreign acquirers for U.S. targets in the pre-reform period. β_2 captures the difference in likelihood that a transaction is structured as a TSA for foreign acquirers buying U.S. targets following the reform. β_3 captures the difference in likelihood that a transaction is structured as a

TSA between cross-border and non-cross-border transactions for foreign acquirers in the pre-reform period.

The interaction terms allow these effects to vary across dimensions. β_4 captures the incremental post-reform change in the likelihood that a transaction is structured as a TSA for U.S. acquirers in domestic transactions relative to foreign acquirers. β_5 captures the incremental difference in likelihood that a transaction is structured as a TSA for U.S. acquirers in cross-border transactions relative to foreign acquirers in the pre-reform period. β_6 captures the incremental post-reform change in the likelihood that a transaction is structured as a TSA for foreign acquirers in cross-border transactions relative to non-cross-border transactions. The coefficient on the triple interaction term (β_7) captures the differential change in the likelihood that U.S. acquirers structure XB transactions as TSA relative to foreign acquirers and alternative transaction structures following the 2010 Act. Positive coefficients indicate those subsets of acquisitions are more likely to be structured as a TSA.

In Eq. (8), I examine whether acquisition prices (*Premium* and *Price(Log)*) differ across acquirer location, acquisition structure, and time. I define *XB TSA* as the interaction of *XB* and *TSA*, which captures cross-border taxable stock acquisitions and allows the specification to avoid a four-way interaction.

Consistent with Eq. (7), the main effects capture baseline differences in prices across acquirer location, transaction structure, and time with pairwise interactions allowing these effects to vary across dimensions. The coefficient on the triple interaction term (β_7) captures the incremental change in prices paid by U.S. acquirers for XB TSAs relative to foreign acquirers and alternative transaction structures following the 2010 Act.

I use the same unit of observation, set of control variables, fixed effects, and clustering of standard errors as in Eqs. (5) and (6).

4.4. Repatriation Tax Costs Shaping Foreign Earnings Financial Reporting

To test Hypothesis 3—following the 2010 Act, U.S. multinationals completing cross-border taxable stock acquisitions do not change their designation of foreign earnings as indefinitely reinvested relative to other U.S. multinationals—I estimate the following difference-in-difference specification at the firm-year level using the same sample period as Eqs. (7) and (8):

$$PRE_{i,t} = \alpha + \lambda_{jt} + \beta_1 XB\ TSA_{i,t} + \beta_2 Post\ 901(m)_t + \beta_3 (XB\ TSA * Post\ 901(m))_{i,t} + \sum_k \beta_k PRECONTROL_{i,t}^k + \varepsilon_{i,t}, \quad (9)$$

where *PRE* represents one of three measures of permanently reinvested earnings: *PRE($),* *PRE(^),* or Δ*PRE*. *PRE($)* is the amount of permanently reinvested earnings reported by firm *i* in year *t* scaled by total assets in year *t. PRE(^)* is an indicator equal to one if permanently reinvested earnings increases from year *t*-1 to *t*. Δ*PRE* is the percentage change in permanently reinvested earnings from year *t*-1 to *t*, capturing intensive-margin adjustments in PRE assertions.

These tests differ from prior specifications by using firm-year panel data rather than acquirer-deal observations; accordingly, I cluster standard errors at the firm level. The treatment variable, *Post 901(m)*, equals one for fiscal years ending after December 31, 2010, ensuring alignment with the financial reporting period regardless of deal timing (or deal existence).

β_1 captures the difference in PRE between firms that complete XB TSAs and those that do not in the pre-reform period. β_2 captures the change in PRE for firms that do not complete XB TSAs following the reform. The coefficient on the interaction term (β_3) measures whether firms that complete XB TSAs exhibit differential changes in PRE reporting following the reform relative to firms that do not.[38]

The vector of control variables (*PRECONTROL*) includes acquirer firm-level accounting characteristics associated with foreign earnings and repatriation incentives: firm size (natural log of total assets), cash, non-cash working capital, leverage, sales growth, and return on assets, as well as the target's corporate tax rate, when applicable. For specifications using *PRE($)*, these controls are measured at the beginning of the fiscal year. For specifications using *PRE(^)* or Δ*PRE*, controls are measured as lagged changes to align with the first-difference construction of the dependent variable (Heider and Ljungqvist 2015).

The sample includes U.S. multinational firms that reported non-zero PRE during the sample period. All specifications include industry-year fixed effects consistent with Eqs. (5)-(8).

4.5. Sample

I construct a global sample of acquisitions using the S&P Capital IQ Transactions database. The database provides M&A transaction-level data on both publicly listed and private targets, acquired by U.S. and foreign acquirers and reported to the Securities and Exchange Commission. My sample includes all M&A transactions by acquiring firms from major

[38] My results are robust to using *Foreign Target * TSA* instead of XB TSA.

international stock exchanges that are completed between 2000 and 2015.[39] I restrict the sample to transactions with available information on acquirer and target location and deal type (*e.g.*, stock vs. asset consideration given and received) with transaction values greater than $1 million: this leaves 61,375 acquirer-transactions. When I further restrict the sample to transactions involving a change in control and multinational firms (foreign firms or U.S. firms that report positive foreign income, foreign taxes, or deferred foreign taxes in the year or two years before the transaction) with non-missing information to construct control variables, 19,630 M&A transactions remain.[40] Spanning 16 years, the total value of M&A deals exceeds $10.4 trillion, with the average size over $533 million (measured before winsorization).

To test my third hypothesis regarding financial statement reporting, I obtain tax footnote disclosure information from Audit Analytics which includes firm-year PRE disclosures for U.S. firms.[41] I match the PRE disclosures with firm characteristics in Compustat and M&A transactions in S&P Capital IQ. I limit my sample to the 5 years before and after the 2010 Act and include firms that disclose a positive amount of PRE or were a multinational firm at some point in the sample period, and those having sufficient control variables. This process leaves 17,597 firm-year observations. Table 2 summarizes these sample selection procedures.

[39] The sample includes acquirers listed on major global stock exchanges as defined by the data provider. Observed primary exchange codes include, *inter alia*: ENXTAM, XTRA, JSE, ASX, SEHK, BME, LSE, SZSE, CPSE, NasdaqCM, BOVESPA, TWSE, TSE, ENXTBR, NYSE, NasdaqGM, OM, ENXTPA, NZSE, ENXTLS, BIT, BVC, SWX, HMSE, NasdaqGS, SGX, IDX, NSEI, TASE, MISX, SET, BMV, WBAG, BSE, HLSE, BASE, BUSE, SNSE, PSE, TSX, KLSE, NYSEAM, KOSE, SHSE, ISE, ATSE, IBSE, BVL, AIM, WSE, DB, NSEL, LJSE, TLSE, DUSE, JMSE, KASE, HOSE, NGM, KOSDAQ, TSXV, ICSE, CASE, BVB, and BDL.

[40] I exclude financial firms, utilities; delete observations with negative sales, negative total assets, book equity below $250,000, and total assets below $500,000 (Amberger and Robinson 2024).

[41] This data series has been discontinued by Audit Analytics, but they provided me with access to the last updated version which covers my sample period (and includes observations to 2022).

TABLE 2
Sample Selection Procedures

			Remaining Observations
Mergers and Acquisitions[a]			61,375
Less	Transactions with ambiguous consideration given		58,839
Less	Transactions lacking change of control		49,001
Less	Transactions by non-multinational firms		26,338
Less	Transactions missing control variables		**19,630**
Less	Transactions after 2010		11,500
Less	Transactions without U.S. acquirer.	Sample of Hypotheses 1	**3,861**
Less	Transactions before 2006	Sample of Hypotheses 2	**15,081**
Permanently Reinvested Earnings[b]			81,668
Less	Firms that never report PRE > 0		41,631
Less	Firm-years with missing control variables.	Sample of Hypothesis 3	**17,597**

[a] Completed transactions with closed dates in years 2000 through 2015, that are not missing acquirer identifying information, acquirer country, transaction value, or consideration detail.

[b] Firm-year observations with fiscal years ending after 01-15-2005 and before 12-15-2016.

4.6. Descriptive Statistics

Table 3 presents descriptive statistics for my sample. Panel A reports summary statistics for the U.S. acquirer pre-reform preferences sample. Panel B reports summary statistics for that same period but for both U.S and foreign acquirers. Panel C reports summary statistics for U.S. and foreign acquirers covering the five-year period before and after the 2010 Act. Finally, Panel D reports summary statistics for firm-year observations used in the analysis of permanently reinvested earnings. I winsorize all continuous, non-tax rate variables at the 1st and 99th percentiles to reduce the influence of outliers.

U.S. acquirers in the pre-reform period (Panel A), structured M&A transactions as taxable stock acquisitions 63% of time. Approximately 33% of targets are foreign. The mean *Target Tax Rate* is 36.3% consistent with the large percentage of U.S. targets. Including foreign

TABLE 3
Descriptive Statistics

Panel A: U.S. Acquirers (2000-2010)

	n	mean	sd	min	p25	p50	p75	max
TSA	3,861	0.632	0.482	0.000	0.000	1.000	1.000	1.000
Foreign Target	3,861	0.330	0.470	0.000	0.000	0.000	1.000	1.000
US Acq	3,861	1.000	0.000	1.000	1.000	1.000	1.000	1.000
Target Tax Rate	3,861	36.349	5.835	0.000	34.430	39.270	39.303	52.030
Acquisition size	3,861	0.110	0.277	0.000	0.008	0.024	0.084	3.671
Size	3,861	7.898	1.822	2.484	6.612	7.831	9.174	14.449
Cash	3,861	0.188	0.231	0.001	0.036	0.094	0.230	1.260
WkCap	3,861	0.261	0.164	-0.343	0.149	0.252	0.359	0.747
Leverage	3,861	0.166	0.140	0.000	0.039	0.156	0.250	0.809
SalesGr	3,861	0.165	0.412	-0.819	0.017	0.100	0.218	5.770
ROA	3,861	0.105	0.082	-0.383	0.061	0.104	0.148	0.382
Premium	3,861	0.998	0.132	0.260	1.000	1.000	1.000	2.298
Log(Price)	3,861	4.165	1.866	0.095	2.833	4.007	5.384	10.600
High-tax (Med)	3,861	0.605	0.489	0.000	0.000	1.000	1.000	1.000

Panel B: U.S. & Foreign Acquirers (2000-2010)

	n	mean	sd	min	p25	p50	p75	max
TSA	11,500	0.689	0.463	0.000	0.000	1.000	1.000	1.000
Foreign Target	11,500	0.671	0.470	0.000	0.000	1.000	1.000	1.000
US Acq	11,500	0.343	0.475	0.000	0.000	0.000	1.000	1.000
Target Tax Rate	11,500	33.028	7.416	0.000	30.000	34.000	39.270	54.000
Acquisition size	11,500	0.107	0.783	0.000	0.003	0.015	0.066	56.093
Size	11,500	8.380	2.612	2.069	6.619	8.149	10.025	17.296
Cash	11,500	0.176	0.210	0.001	0.045	0.102	0.215	1.260
WkCap	11,500	0.251	0.168	-0.343	0.131	0.239	0.357	0.747
Leverage	11,500	0.156	0.135	0.000	0.033	0.137	0.241	0.809
SalesGr	11,500	0.189	0.478	-0.999	0.014	0.104	0.247	5.770
ROA	11,500	0.092	0.085	-0.383	0.052	0.091	0.135	0.382
Premium	11,500	0.952	0.180	0.204	1.000	1.000	1.000	2.298
Log(Price)	11,500	3.854	2.019	0.095	2.332	3.689	5.163	10.600
High-tax (Med)	11,500	0.413	0.492	0.000	0.000	0.000	1.000	1.000

TABLE 3 – *Continued*
Descriptive Statistics

Panel C: FTC Hyping Limitations from the 2010 Act (2006-2015)

	n	mean	sd	min	p25	p50	p75	max
TSA	15,081	0.692	0.462	0.000	0.000	1.000	1.000	1.000
XB TSA	15,081	0.341	0.474	0.000	0.000	0.000	1.000	1.000
Foreign Target	15,081	0.723	0.447	0.000	0.000	1.000	1.000	1.000
XB	15,081	0.455	0.498	0.000	0.000	0.000	1.000	1.000
US Acq	15,081	0.289	0.453	0.000	0.000	0.000	1.000	1.000
Post 901(m)	15,081	0.517	0.500	0.000	0.000	1.000	1.000	1.000
US Acq * Post 901(m)	15,081	0.151	0.358	0.000	0.000	0.000	0.000	1.000
Target Tax Rate	15,081	30.840	7.950	0.000	25.000	30.175	39.075	40.000
Acquisition size	15,081	0.090	0.249	0.000	0.002	0.012	0.056	2.457
Size	15,081	8.517	2.684	1.665	6.781	8.290	10.092	17.222
Cash	15,081	0.196	0.225	0.002	0.055	0.120	0.242	1.467
WkCap	15,081	0.239	0.166	-0.208	0.117	0.225	0.344	0.747
Leverage	15,081	0.151	0.141	0.000	0.015	0.128	0.238	0.622
SalesGr	15,081	0.171	0.413	-0.825	0.011	0.094	0.228	4.214
ROA	15,081	0.084	0.089	-0.574	0.048	0.083	0.126	0.385
Premium	15,081	0.947	0.175	0.200	1.000	1.000	1.000	1.697
Log(Price)	15,081	3.791	1.973	0.095	2.311	3.630	5.079	9.735
High-tax (Med)	15,081	0.455	0.498	0.000	0.000	0.000	1.000	1.000

Panel D: Permanently Reinvested Earnings (2006-2015)

	n	mean	sd	min	p25	p50	p75	max
PRE($)	17,597	0.041	0.102	0.000	0.000	0.000	0.006	0.705
PRE(^)	17,597	0.199	0.399	0.000	0.000	0.000	0.000	1.000
ΔPRE	17,597	0.041	0.334	-1.000	0.000	0.000	0.000	6.203
XB TSA	17,597	0.064	0.245	0.000	0.000	0.000	0.000	1.000
Post 901(m)	17,597	0.081	0.273	0.000	0.000	0.000	0.000	1.000
XB TSA * Post 901(m)	17,597	0.032	0.175	0.000	0.000	0.000	0.000	1.000
Target Tax Rate	17,597	5.701	13.060	0.000	0.000	0.000	0.000	39.540
Size	17,597	0.016	0.052	-0.151	-0.003	0.007	0.023	0.530
Cash	17,597	0.381	1.574	-0.946	-0.269	0.022	0.421	14.296
WkCap	17,597	-0.007	0.638	-4.264	-0.133	-0.002	0.128	5.817
Leverage	17,597	1.641	12.019	-1.000	-0.231	-0.014	0.213	216.557
SalesGr	17,597	0.131	0.331	-0.666	-0.012	0.079	0.198	3.548
Profitability	17,597	0.018	2.297	-17.148	-0.255	0.067	0.334	19.823

Table 3 presents summary statistics for key variables used in the analyses. **Panel A** reports statistics for the U.S. acquirers in the pre-reform period; **Panel B** reports statistics for U.S and foreign acquirers in the pre-reform period; **Panel C** reports statistics for U.S. and foreign acquirers in the five-year period before and after the 2010 Act; and **Panel D** reports statistics for the firm-year panel used in the PRE analysis. All continuous variables are winsorized at the 1st and 99th percentiles. Appendix C provides variable definitions.

acquirers in the sample (Panel B) increases the use of taxable stock acquisitions to 69% and foreign targets representing 67% of transactions. Here U.S. acquirers make up 34% of the sample.

Panel D summarizes the sample of U.S. firm-year observations used in the analysis of PRE financial reporting. In the sample, 20% of observations disclosed increases in PRE with the average change being an increase of 4.1%. XB TSAs occurred in 6.4% of firm-years. Here, *Target Tax Rate* is diluted by firm-years without transactions.

Table 4 provides additional descriptive information on M&A transactions. Panel A reports the number of transactions and average deal value by year for all deals, as well as subsets involving U.S. acquirers, foreign targets, taxable stock acquisitions, and XB-TSAs. Deal activity built up to a peak in 2007, declined in subsequent years reflecting the effects of the global financial crisis, and then begun to increase to a high in 2015. Figure 1 illustrates similar trends by transaction type, with deal count plotted as a solid line (left-hand y-axis) and average deal value plotted as a dashed line (right-hand y-axis) over time. Foreign targets consistently outnumber U.S. targets, though U.S. targets tend to command higher prices. Most transactions involve same-border acquirer-target pairs, although cross-border deals are slightly more expensive on average. Table 4 Panel B lists all countries with at least ten transactions involving either the target or acquirer. The most represented countries include the G7 nations, along with Australia, China, and Sweden. Figure 2 plots the top 10 acquirer countries over time. There is a pronounced dip surrounding the global financial crisis, and China outpaces other nations in recent in M&A transaction growth.

TABLE 4
M&A Transaction Descriptives

Panel A: M&A Transactions by Year

Year	Deals(n)	Mean	U.S. Acq(n)	Mean	Foreign Target(n)	Mean	TSA(n)	Mean	XB TSA(n)	Mean
2000	627	$ 2,041.08	351	$ 1,027.46	233	$ 3,573.43	337	$ 918.76	185	$ 467.56
2001	739	$ 707.83	344	$ 814.41	407	$ 475.37	467	$ 430.04	243	$ 630.79
2002	637	$ 516.08	271	$ 733.94	404	$ 352.01	412	$ 315.44	219	$ 341.19
2003	716	$ 788.45	292	$ 442.90	455	$ 981.07	472	$ 187.73	251	$ 180.60
2004	706	$ 313.17	304	$ 240.42	435	$ 334.15	503	$ 201.85	255	$ 220.78
2005	1,111	$ 445.67	370	$ 599.21	769	$ 359.19	846	$ 360.52	448	$ 387.86
2006	1,415	$ 510.13	417	$ 866.72	1,000	$ 350.98	1,030	$ 451.12	520	$ 415.27
2007	1,654	$ 558.14	455	$ 464.78	1,179	$ 576.25	1,281	$ 568.52	693	$ 756.31
2008	1,517	$ 577.38	435	$ 321.89	1,080	$ 503.64	1,072	$ 652.28	596	$ 983.84
2009	979	$ 356.62	275	$ 618.26	738	$ 220.53	592	$ 452.08	285	$ 255.45
2010	1,444	$ 423.85	448	$ 556.36	1,040	$ 368.28	922	$ 341.65	426	$ 379.87
2011	1,743	$ 388.46	485	$ 394.06	1,307	$ 328.74	1,219	$ 416.19	600	$ 556.50
2012	1,597	$ 405.25	487	$ 431.98	1,111	$ 366.95	1,118	$ 341.08	547	$ 294.81
2013	1,370	$ 350.26	382	$ 313.92	1,046	$ 284.92	923	$ 360.86	425	$ 545.62
2014	1,617	$ 340.46	477	$ 548.80	1,130	$ 215.12	1,096	$ 299.14	524	$ 316.42
2015	1,758	$ 692.23	496	$ 733.57	1,286	$ 626.53	1,180	$ 451.81	536	$ 436.28

TABLE 4 – *Continued*
M&A Transaction Descriptives

Panel B: M&A Transactions by Country

Country	Target	Acquirer	Country	Target	Acquirer	Country	Target	Acquirer
Argentina	86	27	Hong Kong	240	134	Philippines	32	16
Australia	1016	1030	Hungary	26	13	Poland	137	98
Austria	77	66	India	567	682	Portugal	49	23
Belgium	134	165	Indonesia	155	116	Romania	32	2
Bermuda	40	330	Ireland	97	498	Russia	131	48
Brazil	540	438	Isle of Man	1	19	Saudi Arabia	13	1
British Virgin Islands	157	20	Israel	166	180	Serbia	23	0
Bulgaria	13	0	Italy	350	297	Singapore	163	170
Canada	597	403	Japan	967	1395	Slovenia	22	12
Cayman Islands	48	379	Jersey	4	76	South Africa	169	126
Chile	70	21	Kazakhstan	13	0	South Korea	247	277
China	2191	1953	Latvia	11	0	Spain	258	249
Colombia	51	14	Lithuania	25	2	Sweden	344	711
Curaçao	1	10	Luxembourg	37	119	Switzerland	237	294
Cyprus	15	3	Malaysia	54	1	Taiwan	134	151
Czech Republic	58	3	Mexico	149	112	Thailand	97	108
Democratic Republic of the Congo	11	0	Mongolia	10	0	Turkey	67	11
Denmark	145	124	Morocco	10	0	Ukraine	17	0
Egypt	25	1	Netherlands	314	322	United Arab Emirates	35	5
Finland	130	203	New Zealand	101	65	United Kingdom	1974	1842
France	564	647	Nigeria	14	1	United States	6465	6335
Germany	795	630	Norway	241	282	Uruguay	15	0
Greece	38	22	Peru	43	12	Vietnam	28	2

Table 4 summarizes M&A activity in the sample period. Deal values are measured in millions of U.S. dollars. **Panel A** reports the annual number of transactions and average deal value for all deals, U.S. acquirer deals, non-U.S. target deals, and cross-border taxable stock acquisition deals. **Panel B** lists all countries (alphabetically) with at least ten transactions (as either the target or acquirer) along with the corresponding transaction counts.

Figure 1

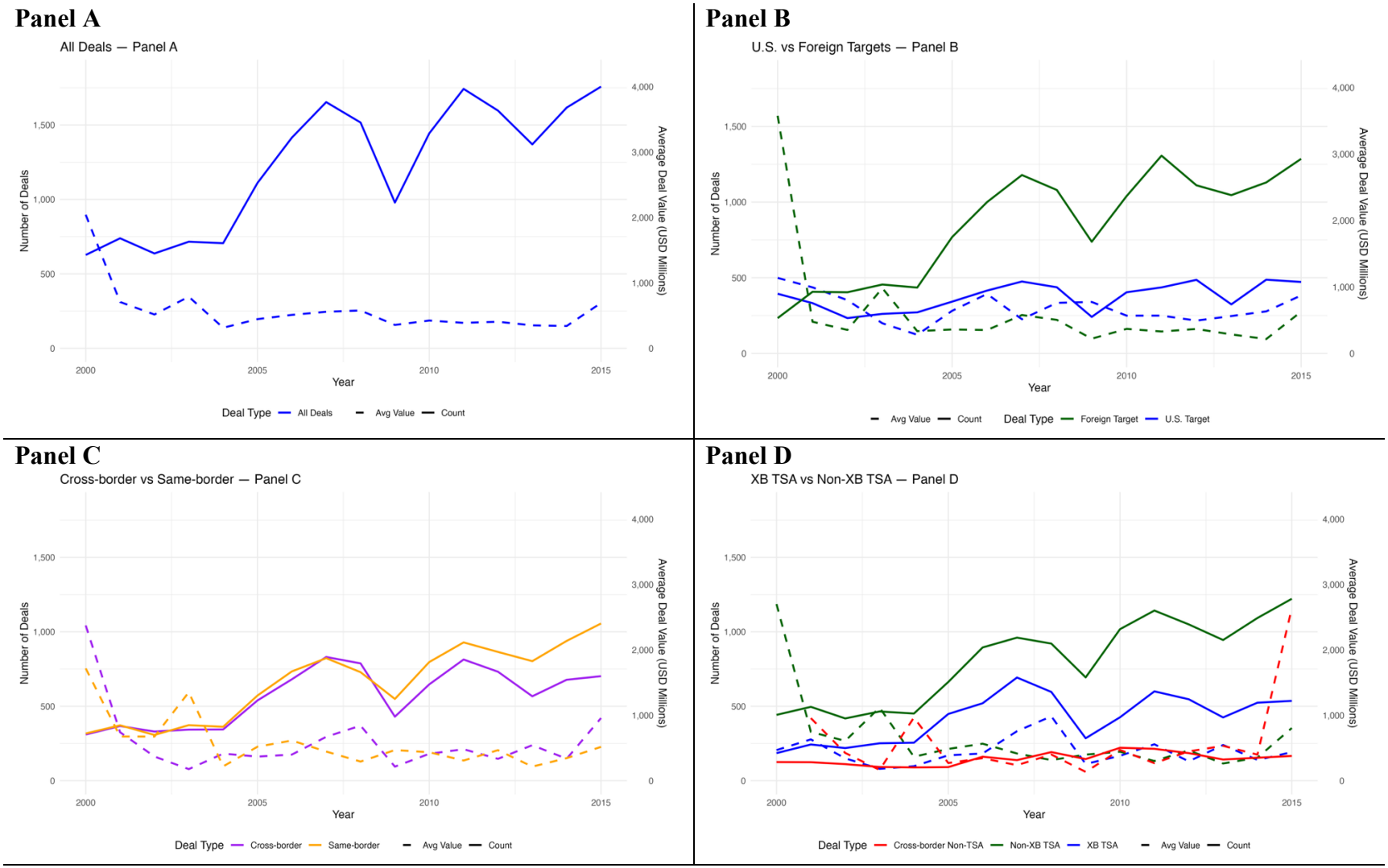


Figure 1 graphs deal volume (solid line, left y-axis) and average deal value (dashed line, right y-axis) over the sample period. **Panel A** depicts all deals; **Panel B** displays U.S. *vs.* foreign targets; **Panel C** graphs same-border *vs*. cross-border deals; and **Panel D** presents XB TSA, non-XB TSA, and cross-border non-TSA deals. The values in these graphs correspond to the values in Table 4 Panel A.

Figure 2

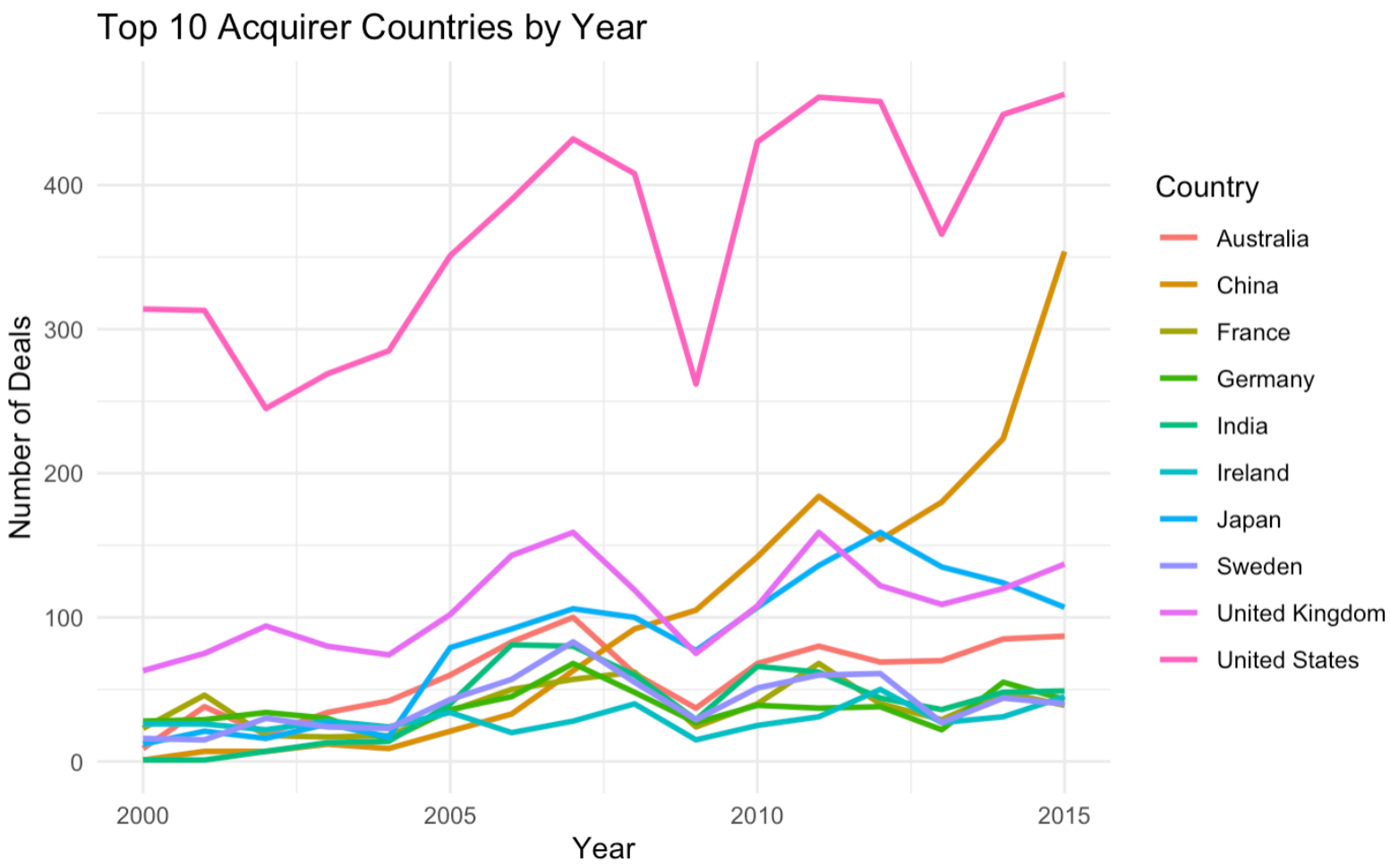


Figure 2 plots the annual number of M&A transactions by acquirer country for the ten most active acquirer countries in the sample. The sample includes transactions announced prior to January 1, 2016. The figure illustrates cross-country differences and time-series variation in acquisition activity over the sample period.

CHAPTER V

RESULTS

5.1. U.S. vs. Foreign Targets in Taxable Stock Acquisitions – Likelihood

5.1.1. U.S. Acquirers

Table 5 reports the results from Eqs. (5) and (6), which test Hypotheses 1A and 1B. Panel A tests whether the likelihood that a M&A transaction is structured as a TSA differs between foreign and U.S. targets. Columns (1) to (4) restrict the sample to U.S. acquirers in the pre-2011 period (n = 3,861): column (1) reports univariate results; column (2) adds control variables; column (3) includes industry-year fixed effects; and column (4) provides a robustness check using PPML estimation.

Across all specifications, the coefficient on *Foreign Target* is positive and statistically significant, ranging from 0.133 to 0.244 (all p-values < 0.01). The preferred linear probability specification in column (3) (β_1= 0.157, p-value < 0.01) indicates that foreign targets are 15.7 percentage points more likely to be acquired in taxable stock acquisitions relative to U.S. targets. Given the baseline TSA rate of 63.2%, this corresponds to a 24.8% relative increase. The PPML specification in column (4) captures the proportional differences, the coefficient on β_1 of 0.244 (p-value < 0.01) translates into a 27.6% increase ($e^{0.244}$-1) in the likelihood that a U.S. acquirer structures the acquisition of a foreign target as a TSA.

In these tests *Target Tax Rate* is not statistically significant. Among the other control variables, TSA is negatively associated with both *Acquisition size* and *Size*, but a positively associated with *Decile Price*. I interpret these findings to mean that larger acquirers and relatively larger deals are less likely to be structured as TSAs, but higher-valued transactions are more likely to use this structure. Further, firms with greater cash balances (*Cash*) and higher

TABLE 5

U.S. Acquirer's Domestic *vs.* Foreign Targets in Taxable Stock Acquisition

Panel A: Likelihood (2000-2010)

	(1) TSA	(2) TSA	(3) TSA	(4) TSA	(5) TSA	(6) TSA
Foreign Target	0.133***	0.150***	0.157***	0.244***	0.058***	0.085***
	(6.31)	(4.90)	(5.47)	(5.73)	(2.60)	(2.66)
US Acq					-0.071***	-0.119***
					(-3.06)	(-3.31)
Foreign Target * US Acq					0.051*	0.083**
					(1.85)	(2.02)
Target Tax Rate		0.001	0.003	0.004	-0.003***	-0.003***
		(0.27)	(1.06)	(1.15)	(-2.68)	(-2.82)
Acquisition size		-0.190***	-0.158***	-0.346***	-0.020**	-0.229***
		(-5.01)	(-4.12)	(-3.70)	(-2.41)	(-4.58)
Size		-0.015**	-0.010	-0.025**	0.006**	0.001
		(-2.09)	(-1.42)	(-2.09)	(2.22)	(0.35)
Cash		0.191***	0.150***	0.239***	0.100***	0.161***
		(3.84)	(3.07)	(3.29)	(3.67)	(4.01)
WkCap		0.128	0.120	0.182	0.091**	0.137**
		(1.60)	(1.41)	(1.40)	(2.16)	(2.29)
Leverage		-0.062	-0.074	-0.100	0.070	0.108
		(-0.61)	(-0.85)	(-0.72)	(1.49)	(1.58)
SalesGr		-0.060***	-0.063***	-0.144**	-0.017	-0.028
		(-2.72)	(-2.84)	(-2.49)	(-1.57)	(-1.46)
ROA		0.545***	0.426***	0.750***	0.642***	0.968***
		(4.94)	(3.39)	(3.67)	(9.28)	(9.03)
Decile Price		0.023***	0.019***	0.034***	-0.004	0.002
		(4.43)	(3.80)	(4.10)	(-1.58)	(0.52)
Constant	0.588***	0.448***	0.391***	-0.763***	0.619***	-0.434***
	(39.64)	(3.04)	(3.63)	(-4.61)	(12.58)	(-6.20)
Observations	3,861	3,861	3,861	3,861	11,500	11,500
Within R2	0.017	0.053	0.040		0.035	
Overall R2	0.017	0.053	0.183		0.125	
Fixed Effects	None	None	Yr*Ind	Yr*Ind	Yr*Ind	Yr*Ind
Period	2000-2010	2000-2010	2000-2010	2000-2010	2000-2010	2000-2010
Sample	US Acq	US Acq	US Acq	US Acq	US & For Acq	US & For Acq
Model	OLS	OLS	OLS	PPML	OLS	PPML

TABLE 5 – *Continued*
U.S. Acquirer's Domestic *vs.* Foreign Targets in Taxable Stock Acquisition

Panel B: Price (2000-2010)

	(1) Premium	(2) Premium	(3) Premium	(4) Log(Price)	(5) Premium	(6) Log(Price)
Foreign Target	-0.018***	-0.027***	-0.029***	-0.076	-0.002	-0.231**
	(-2.60)	(-2.98)	(-2.77)	(-0.62)	(-0.27)	(-2.01)
TSA	0.005	-0.002	-0.008	0.257***	-0.005	0.321***
	(0.88)	(-0.32)	(-1.30)	(3.59)	(-0.96)	(4.36)
Foreign Target * TSA	-0.033***	-0.029***	-0.025**	-0.180	-0.072***	-0.764***
	(-3.13)	(-2.74)	(-2.19)	(-1.44)	(-8.97)	(-7.40)
US Acq					0.009	0.224**
					(1.37)	(2.56)
Foreign Target * US Acq					-0.014	0.079
					(-1.25)	(0.56)
Foreign Target * US Acq * TSA					0.044***	0.468***
					(3.90)	(3.36)
Target Tax Rate		-0.001**	-0.001**	0.008	0.000	-0.003
		(-2.29)	(-2.22)	(1.46)	(0.13)	(-0.84)
Acquisition size		0.008	0.013	3.402***	0.005***	0.392
		(1.13)	(1.60)	(13.06)	(4.47)	(1.41)
Size		-0.003	-0.004*	0.607***	-0.011***	0.307***
		(-1.26)	(-1.77)	(29.17)	(-10.92)	(22.31)
Cash		0.075***	0.050***	-0.175	0.013	-0.165
		(5.38)	(3.45)	(-1.35)	(1.21)	(-1.58)
WkCap		0.019	-0.006	0.167	0.036**	-0.624***
		(0.99)	(-0.26)	(0.77)	(2.40)	(-3.57)
Leverage		-0.003	0.008	0.327	0.028*	0.301
		(-0.14)	(0.39)	(1.44)	(1.69)	(1.55)
SalesGr		-0.004	-0.002	-0.159**	0.006	-0.140***
		(-0.92)	(-0.24)	(-2.04)	(1.44)	(-3.51)
ROA		0.022	0.037	0.294	0.047*	1.241***
		(0.41)	(0.72)	(0.86)	(1.75)	(4.63)
Decile Price		0.008***	0.009***		0.011***	
		(7.15)	(7.40)		(12.97)	
Constant	1.009***	1.020***	1.031***	-1.462***	0.999***	1.584***
	(356.33)	(31.13)	(31.75)	(-4.60)	(52.53)	(6.81)
Observations	3,861	3,861	3,861	3,861	11,500	11,500
Within R2	0.025	0.067	0.060	0.485	0.098	0.227
Overall R2	0.025	0.067	0.180	0.579	0.174	0.317
Fixed Effects	None	None	Yr*Ind	Yr*Ind	Yr*Ind	Yr*Ind
Period	2000-2010	2000-2010	2000-2010	2000-2010	2000-2010	2000-2010
Sample	US Acq	US Acq	US Acq	US Acq	US & For Acq	US & For Acq
Model	OLS	OLS	OLS	OLS	OLS	OLS

Table 5 reports results for Eqs. (5) and (6), testing Hypotheses 1A and 1B. **Panel A** estimates the likelihood that a transaction is structured as a TSA using linear probability and Poisson Pseudo-Maximum Likelihood regressions. Column (1) includes univariate results, column (2) adds control variables, column (3) adds industry-year fixed effects, column (4) reports PPML results, and columns (5) and (6) include foreign acquirers (n = 11,500). **Panel B** estimates whether foreign targets acquired in TSAs are associated with different acquisition prices. All continuous variables are winsorized at the 1st and 99th percentiles. All variables are defined in Appendix C. T-statistics are reported below coefficient estimates in parentheses. Standard errors not reported are clustered by acquirer name. ***, **, and * indicate statistical significance at the 1%, 5%, and 10% levels, respectively.

profitability (*ROA*) are more likely to structure M&A transactions as TSAs, but less likely when sales growth is increasing (*SalesGr*), possibly suggesting these firms' stock prices are also increasing making tax-deferred acquisitions more attractive.

5.1.2. U.S. & Foreign Acquirers

In columns (5) and (6) I expand the sample to include foreign acquirers in the pre-2011 period (n = 11,500) and add *US Acq* and *Foreign Target * US Acq* to regression Eq. (5). Columns (5) and (6) report the OLS and PPML specifications, respectively. *Foreign Target* remains positive and statistically significant (β_1= [0.058, 0.085], p-values < 0.01). In these specifications, *Foreign Target* captures the likelihood that a transaction involving a foreign acquirer and non-U.S. target is structured as a TSA.

The coefficient on *US Acq* (β_2= [-0.071, -0.119], p-values < 0.01) captures the likelihood that a U.S. acquirer, relative to a foreign acquirer, structure the acquisition of a U.S. target as a TSA. Using OLS, U.S. acquirers are 7.1 percentage points less likely to structure acquisitions of U.S. targets as TSAs relative to foreign acquirers. Using non-linear, PPML estimation, U.S. acquirers are approximately 11.2% less likely to structure these transactions as TSAs ($e^{-0.119}$-1). These results are consistent with Erickson and Wang (2007), who show that U.S. C corporations are less likely to be structured as TSA given the two-layers of taxation associated with §338 elections.

In contrast, the coefficient on the interaction term *Foreign Target * US Acq* is positive and statistically significant (β_3= [0.051, 0.083], p-value < 0.1 and < 0.05, respectively), capturing the incremental increase in likelihood that a U.S. acquirer structures the acquisition of a foreign target as a TSA. Taken together, these results indicate that while U.S. acquirers are less

likely to use TSAs for U.S. targets, they are more likely to do so when acquiring foreign targets, consistent with structuring incentives related to FTC hyping.

With the inclusion of foreign acquirers, *Target Tax Rate* is negative and statistically signification (p-value < 0.01), consistent with prior literature (Hines 1996; Huizinga and Voget 2009; Arulampalam *et al.* 2019). In unablated cross-sectional results, I partition the targets into above and below median corporate tax rates but do not find differences when splitting the sample In these tests, the positive relationship between TSA and working capital (*WkCap*) becomes statistically significant (p-value < 0.05), while the negative relationship with sales growth (*SaleGr*) becomes insignificant (p-value > 0.10). Overall, the results in Table 5, Panel A are consistent with Hypothesis 1A.

5.2. U.S. vs. Foreign Targets in Taxable Stock Acquisitions – Acquisition Pricing

Panel B reports the results from Eq. (6), testing whether acquisition pricing differs for U.S. acquirers of foreign targets in TSAs, relative to foreign acquirers and alternative transaction structures. Columns (1) to (4) mirror Panel A, restricting the sample to U.S. acquirers (n = 3,861). In the preferred specification for acquisition premium (column (3)), *Foreign Target* and *Foreign Target * TSA* are negative and statistically significant (p-values < 0.05). When measuring price as the natural log of total transaction value (*Log(Price)*) the coefficients remains negative but insignificant (p-values > 0.10). Within this limited sample of acquisitions, foreign targets—whether acquired in TSAs or not—are associated with lower acquisition prices, but these tests do not allow me to speak to the relative competitiveness of U.S. firms to foreign firms in the foreign M&A market.

To test Hypothesis 1B, whether U.S. acquirers pay higher acquisition prices for foreign targets in taxable stock acquisitions, relative to *foreign* acquirers and alternative acquisition structures, I expand the sample to include foreign acquirers in columns (5) and (6) (n = 11,500), estimating Eq. (6) with *Premium* and *Log(Price)* as the dependent variable, respectively. In column (5), the key coefficient is on the triple interaction term *Foreign Target * US Acq * TSA* (β_7= 0.044, p-value < 0.01), which captures the incremental price paid by U.S. acquirers for non-U.S. targets in TSA transactions relative to foreign acquirers and other transaction structures. Compared with the coefficient on *Foreign Target * US Acq* (β_5= -0.014, p-value > 0.10), the positive and significant coefficient on the triple interaction indicates that U.S. acquirers pay higher acquisition premiums specifically for foreign targets acquired in TSA transactions.

In contrast, the coefficient on *Foreign Target * TSA* (β_4= -0.072, p-value < 0.01) indicates that foreign acquirers purchasing non-U.S. targets in TSAs pay lower acquisition premiums. These patterns are consistent when the dependent variable is *Log(Price)* reported in column (6). Overall, these results are consistent with theoretical predictions developed in Section 3 and consistent with Hypothesis 1B. I find evidence that FTC hyping tax benefits are capitalized into acquisition prices uniquely for U.S. acquirers of foreign targets in TSAs in the pre-form period. Thus, U.S. acquirers may possess a tax-driven competitive advantage in the market for foreign targets, enabling them to outbid foreign acquirers in transactions where FTC hyping benefits are available.[42]

[42] In untabulated analyses, I extend the specifications in Eqs. (5) and (6) to a pre- and post-reform setting within the sample of U.S. acquirers, examining differences across foreign and U.S. targets. In this setting the parallel trends assumption is not supported, and the regression estimates do not yield statistically significant effects.

5.3. FTC Hyping Limitations from the 2010 Act

5.3.1. Likelihood

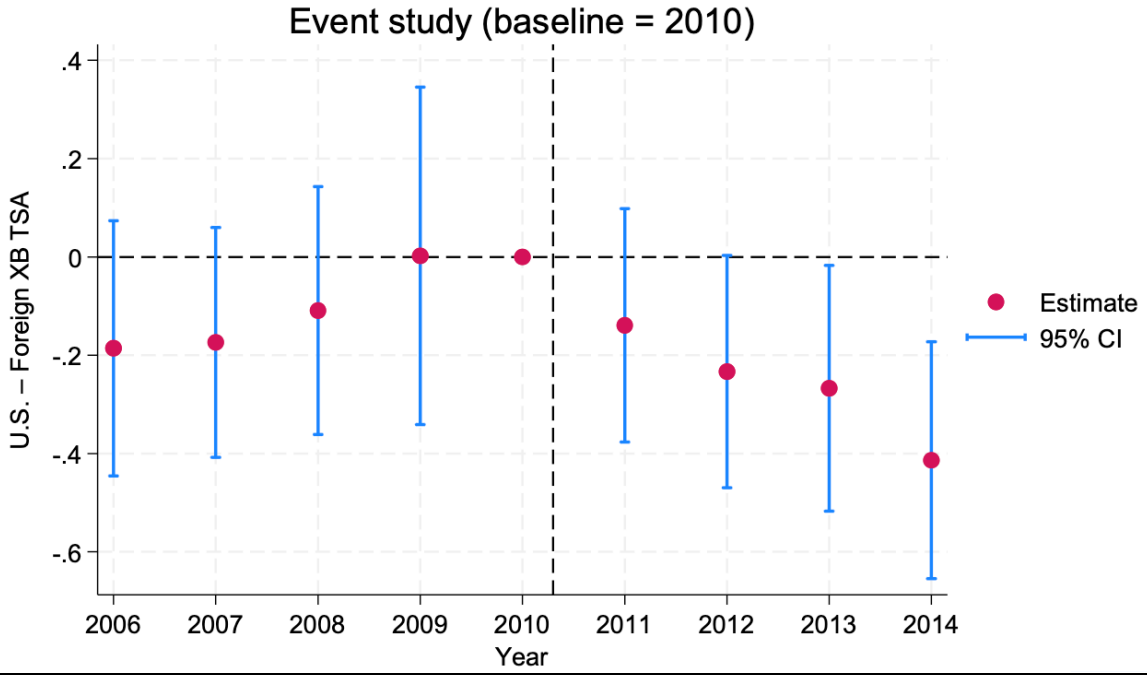
Table 6 reports the main results testing Hypotheses 2A and 2B using the difference-in-differences specifications in Eqs. (7) and (8). This research design strengthens the basis for causal interpretation by comparing pre- and post-reform changes in acquisition structuring and pricing for U.S., relative to foreign, acquirers, removing time-invariant group difference and time trend biases.

The key identifying assumption of this design is that, absent the reform, outcomes for U.S. and foreign acquirers would have followed parallel trends. To test this assumption, I estimate event-study specifications that replace the post-reform indicator with a series of relative-year indicators interacted with the treatment group (*US Acq * XB*). This specification allows me to examine whether treated and control transactions exhibit differential trends prior to the reform and to trace the timing of any post-reform changes. Figure 3, Panel A plots the estimated coefficients on these relative-year interactions, along with 95% confidence intervals, using 2010 as the baseline year. The pre-reform coefficients are small and statistically insignificant, and a joint test fails to reject that the pre-treatment coefficients are equal to zero (χ^2= 3.29, p-value = 0.51), providing support for the parallel trends assumption.

Motivated by this evidence, I proceed to the difference-in-differences estimates in Table 6. Panel A reports results from Eq. (7), examining whether the likelihood that U.S. acquirers structure XB transactions as TSAs changes following the 2010 Act, relative to foreign acquirers and alternate transactions structures (n = 15,081). Columns (1) to (3) estimate Eq. (7) using OLS with increasing rich controls and column (4) reports the results from PPML estimation.

Figure 3
Parallel Trends Tests

Panel A: FTC Hyping Limitations from the 2010 Act



Panel B: Permanently Reinvested Earnings

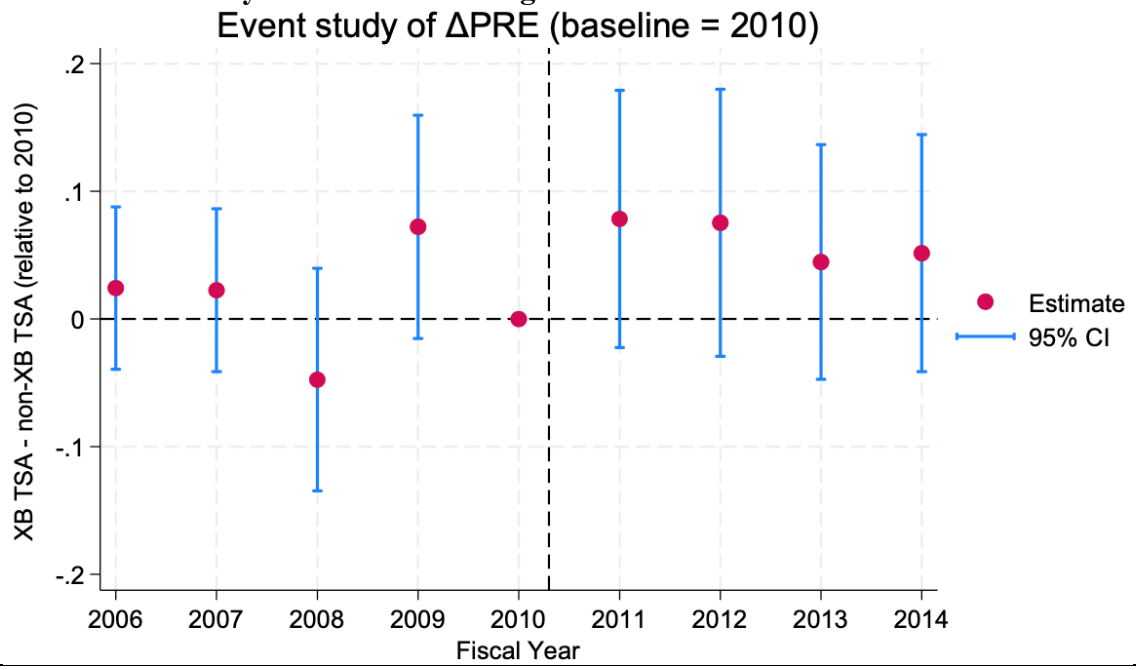


Figure 3 presents event-study estimates used to assess the parallel trends assumption underlying the difference-in-difference designs. Coefficients are reported relative to the baseline year 2010, with 95% confidence intervals. **Panel A** examines the likelihood that a transaction is structured as a TSA for U.S. *vs.* foreign acquirers in the cross-border settings. **Panel B** examines changes in PRE for firms engaging in cross-border taxable stock acquisitions relative to other U.S. multinationals. Across both panels, pre-reform coefficients are small and statistically insignificant, providing support for the parallel trends assumption.

TABLE 6
FTC Hyping Limitations from the 2010 Act

Panel A: Likelihood (2006-2015)

	(1) TSA	(2) TSA	(3) TSA	(4) TSA	(5) TSA	(6) TSA
US Acq	-0.060**	-0.059**	-0.066***	-0.107***	-0.126***	0.117
	(-2.48)	(-2.37)	(-2.88)	(-3.00)	(-2.70)	(0.71)
Post 901(m)	-0.038**	-0.040**	0.133***	0.224***	0.192*	0.233**
	(-2.30)	(-2.41)	(3.08)	(2.86)	(1.70)	(2.35)
XB	0.079***	0.072***	0.056***	0.078***	0.072*	0.100***
	(4.51)	(4.13)	(3.36)	(3.29)	(1.69)	(3.64)
US Acq * Post901(m)	0.087***	0.097***	0.092***	0.143***	0.122**	-0.391*
	(3.28)	(3.65)	(3.51)	(3.51)	(2.21)	(-1.77)
US Acq * XB	0.038	0.027	0.037	0.066	0.162**	-0.171
	(1.20)	(0.83)	(1.19)	(1.45)	(2.24)	(-1.02)
XB * Post901(m)	0.048**	0.052**	0.059***	0.087***	0.084	0.040
	(2.14)	(2.31)	(2.68)	(2.75)	(1.49)	(1.13)
US Acq * XB * Post901(m)	-0.061	-0.070*	-0.080**	-0.128**	-0.153*	0.422*
	(-1.51)	(-1.70)	(-1.96)	(-2.22)	(-1.75)	(1.85)
Target Tax Rate		-0.002**	-0.003***	-0.004***		
		(-2.46)	(-4.69)	(-4.91)		
Acquisition size		-0.055**	-0.035	-0.076**	-0.074	-0.093*
		(-2.55)	(-1.63)	(-2.07)	(-1.46)	(-1.88)
Size		0.006**	0.009***	0.014***	0.009	0.016***
		(2.15)	(3.75)	(3.79)	(1.45)	(3.94)
Cash		0.127***	0.094***	0.133***	0.101**	0.151***
		(5.21)	(4.08)	(4.01)	(1.97)	(3.81)
WkCap		0.083**	0.019	0.025	0.055	-0.011
		(2.16)	(0.48)	(0.44)	(0.62)	(-0.17)
Leverage		0.001	-0.021	-0.026	-0.179	0.068
		(0.02)	(-0.36)	(-0.31)	(-1.50)	(0.74)
SalesGr		-0.012	-0.007	-0.012	-0.045	0.002
		(-0.95)	(-0.59)	(-0.59)	(-1.28)	(0.08)
ROA		0.601***	0.502***	0.808***	0.577***	0.964***
		(8.95)	(7.91)	(8.06)	(3.90)	(7.92)
Decile Price		-0.003	-0.001	0.000	0.031***	-0.024***
		(-1.12)	(-0.29)	(0.00)	(6.36)	(-6.50)
Constant	0.668***	0.608***	0.554***	-0.583***	-0.796***	-0.622***
	(50.66)	(16.88)	(14.29)	(-9.48)	(-9.02)	(-9.10)
Observations	15,081	15,081	15,081	15,081	6,802	8,203
Within R2	0.015	0.036	0.034			
Overall R2	0.015	0.036	0.107			
Fixed Effects	None	None	Yr*Ind	Yr*Ind	Yr*Ind	Yr*Ind
Period	2006-2015	2006-2015	2006-2015	2006-2015	2006-2015	2006-2015
Sample	All	All	All	All	All	All
Model	OLS	OLS	OLS	PPML	PPML	PPML
CX					High-tax	Low-tax

TABLE 6 – *Continued*
FTC Hyping Limitations from the 2010 Act

Panel B: Price (2006-2015)

	(1) Premium	(2) Premium	(3) Log(Price)	(4) Log(Price)	(5) Log(Price)	(6) Log(Price)
XB TSA	-0.010	-0.011*	0.398***	0.392***	0.789***	0.176**
	(-1.46)	(-1.70)	(5.12)	(5.33)	(6.97)	(2.04)
US Acq	0.046***	0.040***	0.887***	0.933***	1.159***	0.465**
	(7.34)	(6.59)	(12.34)	(13.20)	(12.30)	(2.57)
Post 901(m)	-0.006	-0.002	0.073	-0.752***	-0.825***	-0.797***
	(-1.04)	(-0.14)	(1.36)	(-4.65)	(-3.86)	(-3.64)
US Acq * Post 901(m)	0.003	0.004	-0.054	-0.098	0.225**	-0.346
	(0.40)	(0.55)	(-0.66)	(-1.18)	(2.02)	(-1.42)
XB TSA * US Acq	-0.018	-0.018*	-0.510***	-0.488***	-1.152***	0.234
	(-1.62)	(-1.66)	(-4.38)	(-4.31)	(-6.44)	(1.12)
Post 901(m) * XB TSA	0.017*	0.016*	0.131	0.136	0.362**	0.043
	(1.93)	(1.75)	(1.55)	(1.62)	(2.53)	(0.42)
US Acq * XB TSA * Post901(m)	0.002	0.003	-0.025	-0.059	-0.145	0.100
	(0.18)	(0.25)	(-0.19)	(-0.45)	(-0.64)	(0.37)
Target Tax Rate	0.001***	0.001***	0.006**	0.006**		
	(4.26)	(3.91)	(2.26)	(2.26)		
Acquisition size	0.019***	0.024***	3.421***	3.324***	3.705***	2.967***
	(2.93)	(3.57)	(31.31)	(30.98)	(21.46)	(24.57)
Size	-0.011***	-0.010***	0.377***	0.364***	0.414***	0.338***
	(-11.25)	(-11.22)	(36.31)	(35.26)	(29.83)	(24.98)
Cash	0.011	-0.004	-0.332***	-0.348***	-0.209	-0.374***
	(1.28)	(-0.52)	(-3.93)	(-4.06)	(-1.64)	(-3.67)
WkCap	0.052***	0.049***	-0.688***	-0.651***	-0.749***	-0.480***
	(4.51)	(3.98)	(-5.44)	(-4.97)	(-3.55)	(-3.20)
Leverage	0.036**	0.033**	0.741***	0.703***	0.815***	0.655***
	(2.30)	(2.24)	(4.31)	(4.47)	(4.06)	(3.02)
SalesGr	-0.000	-0.001	-0.109**	-0.113**	-0.159***	-0.075
	(-0.07)	(-0.15)	(-2.05)	(-2.18)	(-2.67)	(-1.13)
ROA	0.025	0.016	2.508***	2.631***	2.344***	2.559***
	(1.30)	(0.84)	(11.29)	(12.10)	(6.87)	(9.83)
Decile Price	0.011***	0.011***				
	(14.12)	(14.94)				
Constant	0.912***	0.914***	-0.397***	0.134	-0.354*	0.637***
	(72.15)	(63.16)	(-3.21)	(0.94)	(-1.73)	(3.61)
Observations	15,081	15,081	15,081	15,081	6,837	8,212
Within R2	0.084	0.075	0.364	0.351	0.389	0.304
Overall R2	0.084	0.129	0.364	0.407	0.470	0.389
Fixed Effects	None	Yr*Ind	None	Yr*Ind	Yr*Ind	Yr*Ind
Sample	All	All	All	All	All	All
Period	2006-2015	2006-2015	2006-2015	2006-2015	2006-2015	2006-2015
Model	OLS	OLS	OLS	OLS	OLS	OLS
CX					High-tax	Low-tax

Table 6 reports results for Eqs. (7) and (8), testing Hypotheses 2A and 2B. **Panel A** estimates whether the likelihood that a transaction is structed as a TSA differs for U.S. acquirers in cross-border M&A transactions following the 2010 Act. Columns (5) and (6) present cross-sectional tests splitting the sample based on above/below median target country's statutory corporate tax rate. **Panel B** estimates whether acquisition premiums and prices paid by U.S. acquirers in XB TSA changed following the 2010 Act. All continuous variables are winsorized at the 1st and 99th percentiles. All variables are defined in Appendix C. T-statistics are reported below coefficient estimates in parentheses. Standard errors not reported are clustered by acquirer name. ***, **, and * indicate statistical significance at the 1%, 5%, and 10% levels, respectively.

In my preferred specification (column (3)), the coefficient on *US Acq*, capturing pre-reform, same-country acquisitions by U.S. acquirers, is negative and statistically significant (β_1= -0.066, p-value < 0.01), indicating that these transactions are less likely to be structured as TSAs prior to the reform. Adding an interaction with *Post 901(m)*, the interaction term *US Acq * Post 901(m)* captures the incremental post-reform change. The coefficient equals 0.092 (p-value < 0.01) indicating U.S. acquirers use more TSAs for same-country acquisitions in the post-period. The coefficient on the main variable of interest, the triple interaction *US Acq * XB * Post 901(m)*, is negative and statistically significant (β_7= -0.080, p-value < 0.05), indicating U.S. acquirers reduce their use of TSAs for cross-border acquisitions by 8 percentage points after FTC hyping is limited. These results are robust to non-linear PPML estimation reported in column (4), which implies a 12% decrease ($e^{-0.128}$-1) in the likelihood that a cross-border acquisition by a U.S. acquirer is structured as a TSA (β_7= -0.128, p-value < 0.05).

These findings reject Hypothesis 2A and indicate that the limitation of FTC hyping following the 2010 Act reduces the use of taxable stock acquisitions by U.S. acquirers in cross-border transactions relative to foreign acquirers.

In columns (5) and (6), I further examine cross-sectional variation by splitting the sample based on the target country's statutory corporate tax rate (above versus below the median), estimating the specification using PPML. The coefficient on the triple interaction term remains negative for high-tax target countries but becomes positive for low-tax target countries. Despite earlier reasoning that FTC hyping incentives are determined by the acquirer's tax position, these

results indicate that target country characteristics also shape the extent to which such incentives are realized.[43]

5.3.2. Acquisition Pricing

Panel B reports the results from Eq. (8), testing whether acquisition pricing differs for U.S. acquirers of XB TSAs, relative to foreign acquirers and non-XB TSA structures following the 2010 Act. Columns (1) and (2) present results using *Premium* as the dependent variable, with column (2) including industry-year fixed effects. Columns (3) and (4) repeat the analysis using *Log(Price)* as the dependent variable.

The coefficient on *US Acq* in the fully specified regressions is positive and statistically significant (β_1=[0.040, 0.993], p-values < 0.01), indicating that U.S. acquirers pay higher prices than foreign acquirers in non-XB TSA transactions prior to the 2010 Act. Adding interactions with *Post 901(m)* and *XB TSA* does not yield statistically significant relationships, suggesting no differential price effects along these dimensions.

The key coefficient on the triple interaction term *US Acq * XB TSA * Post 901(m)*, is economically small and statistically insignificant across all specifications. This indicates that, despite the reduction in the likelihood that U.S. acquirers structure XB transactions as TSAs following the 2010 Act documented in Panel A, there is no corresponding change in acquisition prices for these transactions.

In columns (5) and (6), I repeat the cross-sectional analysis in Panel A for *Log(Price)*, splitting the sample based on the target country's statutory corporate tax rate. Consistent with the

[43] *See supra* note 27.

main results, the coefficient on the triple interaction term remains statistically insignificant in both subsamples. While the point estimates differ in sign across high- and low-tax groups, they are imprecisely estimated and do not provide evidence of differential price responses across these settings.

Taken together, the results in Panel B indicate that the 2010 Act did not lead to a measurable change in acquisition prices for U.S. acquirers in cross-border taxable stock acquisitions. Consistent with Hypothesis 2B, I fail to reject the null that U.S. acquirers do not pay higher acquisition prices in these transactions following the reform. Although the direction of the coefficients is generally aligned with the patterns observed in Panel A, the lack of statistical significance suggests that any pricing effects are economically small or offset by other economic forces.

5.4. Repatriation Tax Costs Shaping Foreign Earnings Financial Reporting

Table 7 reports the results from the difference-in-differences specification in Eq. (9), testing whether U.S. multinational firms completing targeted acquisitions change their assertions of permanently reinvested earnings following the 2010 Act, relative to other U.S. multinationals. First, I assess the parallel trends assumption underlying the empirical design. Figure 3, Panel B presents event-study estimates. Consistent with Panel A, the pre-reform coefficients are small and statistically indistinguishable from zero, providing support for the parallel trends assumption.

Columns (1) to (3) report the results when PRE is measured as *PRE($)*. Column (1) presents the main independent variables (*XB TSA*, *Post 901(m)*, *XB TSA * Post 901(m)*), column (2) adds control variables, and column (3) adds industry-year fixed effects. This presentation

TABLE 7
Repatriation Tax Costs Shaping Foreign Earnings Financial Reporting

	(1) PRE($)	(2) PRE($)	(3) PRE($)	(4) PRE(^)	(5) PRE(^)	(6) PRE(^)	(7) ΔPRE	(8) ΔPRE	(9) ΔPRE
XB TSA	−0.005	−0.005	−0.001	−0.040**	−0.041**	−0.023	−0.018**	−0.025**	−0.023**
	(−1.34)	(−1.10)	(−0.26)	(−2.46)	(−2.16)	(−1.32)	(−2.23)	(−2.46)	(−2.11)
Post 901(m)	0.044***	0.043***	0.007	0.190***	0.185***	0.017	0.023*	0.014	−0.022
	(6.31)	(7.10)	(1.09)	(9.45)	(8.67)	(0.80)	(1.81)	(0.92)	(−1.36)
XB TSA * Post901(m)	0.026***	0.026***	0.020**	0.088***	0.090***	0.073**	0.059**	0.069***	0.066**
	(2.65)	(2.59)	(2.14)	(2.84)	(2.69)	(2.23)	(2.44)	(2.65)	(2.55)
Target Tax Rate		−0.000	0.000***		0.000	0.002***		0.000	0.000*
		(−0.08)	(3.57)		(0.10)	(4.52)		(1.06)	(1.79)
Size		−0.051***	−0.039***		−0.004	0.059		0.222***	0.195***
		(−5.11)	(−3.39)		(−0.08)	(1.14)		(4.05)	(3.65)
Cash		−0.002***	−0.001***		−0.007***	−0.004***		−0.001	−0.000
		(−6.68)	(−4.32)		(−4.77)	(−2.71)		(−0.68)	(−0.02)
WkCap		0.000	0.000		0.002	0.001		0.001	0.001
		(0.27)	(0.06)		(0.63)	(0.27)		(0.33)	(0.38)
Leverage		0.000	0.000		−0.000	−0.000		−0.000	−0.000
		(0.87)	(0.18)		(−1.00)	(−1.51)		(−0.63)	(−0.51)
SalesGr		−0.020***	−0.011***		−0.066***	−0.025***		0.009	0.019**
		(−10.60)	(−5.61)		(−9.02)	(−3.16)		(1.17)	(2.39)
ROA		0.001***	0.001***		0.004***	0.004***		0.003***	0.003***
		(2.76)	(3.15)		(3.95)	(4.50)		(2.77)	(2.69)
Constant	0.037***	0.041***	0.041***	0.184***	0.196***	0.192***	0.038***	0.033***	0.034***
	(21.50)	(21.13)	(22.00)	(32.14)	(31.02)	(32.52)	(12.45)	(9.91)	(10.17)
Observations	17,597	17,597	17,597	17,597	17,597	17,597	17,597	17,597	17,597
Within R2	0.020	0.028	0.010	0.021	0.025	0.007	0.001	0.003	0.003
Overall R2	0.020	0.028	0.147	0.021	0.025	0.160	0.001	0.003	0.065
Fixed Effects	None	None	Yr*Ind	None	None	Yr*Ind	None	None	Yr*Ind
Model	OLS	OLS	OLS	OLS	OLS	OLS	OLS	OLS	OLS
Sample	PRE	PRE	PRE	PRE	PRE	PRE	PRE	PRE	PRE
Period	2006–2015	2006–2015	2006–2015	2006–2015	2006–2015	2006–2015	2006–2015	2006–2015	2006–2015

Table 7 reports results for Eq. (9), testing Hypothesis 3. The dependent variable is PRE, measured either as the level scaled by total assets (*PRE($)*) in columns (1)-(3), an indicator for an increase in PRE reported (*PRE(^)*) in columns (4)-(6), and the percentage change in PRE reported (Δ*PRE*) in columns (7)-(9) by U.S. multinational firms. The key variable of interest is the interaction between indicators for XB TSA and the post-reform period following the 2010 Act. All continuous variables are winsorized at the 1st and 99th percentiles. Control variables are defined in Appendix C. T-statistics are reported below coefficient estimates in parentheses. Standard errors not reported are clustered by firm. ***, **, and * indicate statistical significance at the 1%, 5%, and 10% levels, respectively.

structure is repeated in columns (4) to (6) when PRE is measured as *PRE(^)*, and again in columns (7) to (9) when PRE is measured as *ΔPRE*.

Across columns (1) to (3), the coefficient on the interaction term *XB TSA * Post 901(m)* is positive and statistically significant (β_3 = [0.026, 0.026, 0.020], p-values < 0.05), indicating that U.S. multinationals completing cross-border taxable stock acquisitions increase the level of permanently reinvested earnings (scaled by total assets) relative to other firms following the reform. This effect is robust to the inclusion of control variables and industry-year fixed effects.

Columns (4) to (6) report results using *PRE(^)*, an indicator for increases in PRE. In the preferred specification (column (6)) the coefficient on *XB TSA * Post 901(m)* remains positive and statistically significant (β_3 = 0.073, p-value < 0.05), indicating that firms completing XB TSAs are more likely to increase their PRE assertions following the reform.

Finally, columns (7) to (9) report positive and statistically significant coefficients for the interaction term *XB TSA * Post 901(m)* across all three specifications. In the main specification (column (9)), the coefficient on the interaction term is 0.066 (p-value < 0.05), indicating that U.S. multinationals completing XB TSAs exhibit larger percentage increases in PRE following the reform.

Focusing on the preferred specifications in columns (3), (6), and (9), the coefficients on the main effects (*XB TSA* and *Post 901(m)*) are generally small and statistically insignificant, indicating no meaningful baseline differences in PRE between treated and control firms or common time trends in PRE unrelated to treatment. The exception is a negative and statistically significant coefficient on *XB TSA* in column (9) (β_1 = -0.023, p-value < 0.05), suggesting that, prior to the reform, U.S. multinationals completing XB TSAs exhibited lower growth in PRE.

This result is consistent with U.S. multinationals enjoying lower repatriation tax costs following XB TSAs prior to the reform because of FTC hyping benefits.

Taken together, the results across all three measures provide consistent evidence that U.S. multinationals completing cross-border taxable stock acquisitions increase their PRE assertions following the 2010 Act. These results reject the null hypothesis that PRE behavior does not change following the reform and are consistent with firms using financial reporting strategies—increasing PRE assertations—to defer repatriation taxes when FTC hyping opportunities are limited.

CHAPTER VI

CONCLUSION

This study examines how U.S. multinational firms respond to foreign direct investment disincentives introduced by the Education, Jobs, and Medicaid Assistance Act of 2010. Using a difference-in-differences research design and a large, globally representative sample of more than 19,000 M&A transactions across U.S. and foreign acquirers, public and private targets, and a wide range of jurisdictions, I test whether restricting foreign tax credit benefits for cross-border taxable stock acquisitions affects acquisition structure, pricing, and financial reporting.

I first develop a framework that links FTC hyping incentives to acquisition structure to predict pre-reform acquisition patterns. I then find that prior to the reform, U.S. acquirers are more likely to structure the acquisition of non-U.S. targets as TSAs, relative to U.S. targets, and pay higher prices for these transactions relative to foreign acquirers, consistent with FTC hyping incentives being capitalized into deal structure and valuation. Following the reform, U.S. acquirers are 8 to 9 percentage points less likely to use TSAs in cross-border transactions, indicating that foreign direct investment decisions respond to targeted tax disincentives. At the same time, I find no evidence of a differential change in acquisition prices for these transactions in the post-reform period. I further document that firms engaging in cross-border TSAs increase PRE, consistent with higher repatriation tax costs and increased incentives to defer the financial reporting of future U.S. taxation. Taken together, these results show that limiting FTC availability alters both real investment decisions and financial reporting behavior.

These findings contribute to several literatures. Consistent with prior evidence that taxes influence acquisition activity (Hines 1996; Huizinga and Voget 2009; Arulampalam *et al.* 2019; Bradley *et al.* 2021; Bührule *et al.* 2023), I identify FTC hyping as a specific mechanism through

which international tax rules affect acquisition structure and foreign direct investment decisions. I extend the literature on tax-motivated acquisition structuring by showing that, in contrast to domestic settings where TSAs are often inefficient for U.S. C corporations (Erickson and Wang 2000, 2007), cross-border transactions can generate substantial tax benefits through FTC planning. I also provide domain-specific evidence that targeted foreign direct investment disincentives affect both real and financial reporting outcomes (Lester 2021), including increased PRE consistent with the lockout of foreign earnings (Fritz Foley *et al.* 2007; Blouin *et al.* 2012). Finally, my results provide policy-relevant evidence that targeted tax disincentives to foreign direct investment can influence firm behavior. The documented changes in acquisition structure and financial reporting following the reform suggest that firms respond to specific features of the FTC system, highlighting the importance of tax design in shaping cross-border investment decisions.

An important consideration in interpreting these results is that M&A transactions are inherently endogenous. Firms jointly determine targets, timing, valuation, and transaction structure based on strategic, operational, and tax considerations, and these choices may be correlated with unobserved factors that also affect outcomes. While the empirical design exploits a plausibly exogenous policy shock and is supported by parallel trends evidence, the estimates should be interpreted as evidence of systematic responses to the reform rather than strictly causal effects. In addition, data limitations constrain the inclusion of certain target- and seller-level characteristics—most notably capital gains tax incentives and detailed target fundamentals. At the same time, the scale and scope of the dataset mitigate some of these concerns. The large sample size and global coverage allow for comparisons across institutional settings, including U.S. and foreign acquirers, European and non-European markets, and public and private targets,

improving external validity relative to studies focused on narrower samples. Moreover, the ability to jointly examine acquisition structure, pricing, and financial reporting within a unified setting provides a more comprehensive view of how firms respond to changes in foreign direct investment disincentives.

Overall, this study provides new evidence that foreign direct investment decisions respond to targeted tax disincentives embedded in the FTC system. Together, these results show that restricting FTC hyping changes how U.S. firms structure acquisitions, value cross-border targets, and report foreign earnings.

APPENDIX A

COVERED ASSET ACQUISITION EXAMPLE

This Appendix A presents an example of the tax consequences of a covered asset acquisition before and after the enactment of §901(m). The example is a simplified adaptation of Treasury Regulation Section (Treas. Reg. §) 1.901(m)-3(b)(3)(ii) *Example 2: Computation of disqualified tax amount*.

Facts

On December 31 of Year 0, USP (a calendar year U.S. corporation) acquires all the stock of CFC1 (a calendar year Country F corporation) in a qualified stock purchase (§338(d)(3)) to which §338(a) applies. CFC1 owns two assets (Asset A and Asset B collectively, Assets) and conducts activities in Country F. The basis step-up from the §338 transaction is 210u for Asset A and 120u for Asset B and the cost recovery periods are 15 and 6 years, respectively. The tax rate is 25% in Country F and 35% in the United States. For Country F tax purposes, CFC1's foreign income and foreign income tax amount for each foreign taxable year 1 through 15 is 100u and $25 (25u translated at the exchange rate of $1 = 1u), respectively. No dispositions occur for any of the Assets during the applicable cost recovery period. Facts relevant to each of the Assets are summarized below.

Assets	Relevant foreign income tax	Basis difference	Applicable cost recovery period (years)	Cost recovery amount
Asset A	Country F tax	210u	15	14u (210u/15)
Asset B	Country F tax	120u	6	20u (120u/6)

Pre-§901(m)

In the period before the application of §901(m), the effective tax rate of CFC1 for U.S. tax purposes is 37.9% (hyped relative to the actual 25% foreign tax rate).

$$\frac{Foreign\ Taxes\ Paid}{Foreign\ earnings\ (U.S.tax\ purposes)} = \frac{25\% \times 100u \times \$1 = \$25}{100u - (210u \div 15\ years) - (120u \div 6\ years) = 66u} = 37.9\%$$

Thus, if CFC1 repatriated all its earnings to USP, there would be no residual U.S. tax because the FTC exceeds the U.S. tax on the foreign earnings. Furthermore, if the foreign income was otherwise subject to immediate U.S. tax (*e.g.*, passive income) an exemption would now be allowed since the foreign tax rate of 37.9% is greater than 90% of the U.S. tax rate of 35% (*see* §954(b)(4) for the high-tax exception).

On December 31 of Year 1, CFC1 repatriates all its cash $75 (100u x $1 - $25) to USP, 100% of its foreign taxes will be deemed paid by USP (41u ÷ 41u x $25 = $25, *see* §902; 41u is calculated as 66u – 25u representing the amount of foreign earnings for U.S. tax purposes after being reduced for foreign taxes paid). USP will be treated as receiving a dividend of $66 (41u x $1 foreign earnings for U.S. tax purposes plus $25 for the foreign taxes deem paid due to the §78 gross up). Since the distribution of $75 exceeds CFC1's foreign earnings for U.S. tax purposes, the excess of $34 ($75 – 41u x $1) should be treated as a reduction in the basis of CFC1's shares (§§301(c)(1), (2)), such that USP's CFC1 basis going forward is $66 ($100 - $34). The U.S. tax on the foreign income is $23.10 (35% x $66), but is entirely offset by $25 in FTCs, leaving an additional $1.90 in FTCs to be carried forward or to offset U.S. tax on other foreign income.

Post-§901(m)

If USP is subject to §901(m) on its foreign stock acquisition, it must compute the disqualified tax amount each year (§901(m)(3)(A)). With respect to Country F tax, in U.S. taxable years 1 through 6, CFC1 has an aggregate basis difference of 34u each year (14u cost recovery amount with respect to Asset A plus 20u cost recovery amount with respect to Asset B). For U.S. taxable years 1 through 6, the disqualified tax amount each year is the lesser of two amounts: the tentative disqualified tax amount (see below) or the foreign income tax amount paid or accrued by CFC1, in this case, $25.

$$Tentative\ disqualified\ tax\ amount = Foreign\ income\ tax\ amount \times \frac{Aggregate\ basis\ difference}{Allocable\ foreign\ income}$$

$$\$8.50 = \$25 \times \frac{34u}{100u}$$

Given that the tentative disqualified tax amount is lower, the amount of foreign taxes paid by CFC1 eligible for the FTC is reduced from $25 to $16.50 ($25 – $8.50). After U.S. taxable year 6, Asset B has no unallocated basis difference with respect to Country F tax. Accordingly, in U.S. taxable years 7 through 15, CFC1 has an aggregate basis difference of 14u each year. Accordingly, for U.S. taxable years 7 through 15, the disqualified tax amount each year is $3.50, the lesser of two amounts: the tentative disqualified tax amount, in this case, $3.50 ($25 foreign income tax amount × (14u aggregate basis difference ÷ 100u allocable foreign income)), or the foreign income tax amount paid or accrued by CFC1, in this case, $25. Thus, in years 7 through 15, the amount of foreign taxes paid by CFC1 eligible for the FTC is reduced from $25 to $21.50 ($25 - $3.50). After U.S. taxable year 15, Asset A has no unallocated basis difference with

respect to Country F tax and, therefore, CFC1 has no disqualified tax amount with respect to Country F Tax.

Despite foreign taxes paid being denied creditability under §901(m), such taxes can still be deducted for U.S. tax purposes, so the entire benefit is not lost (§901(m)(6)).

On December 31 of Year 1, CFC1 repatriates all its cash of $75 (100u x $1 - $25) to USP, 100% of its foreign taxes will be deemed paid by USP (41u ÷ 41u x $25 = $25, *see* §902). USP will be treated as receiving a dividend of $57.50 (41u x $1 foreign earnings for U.S. tax purposes plus $16.50 for the foreign taxes deem paid due to the §78 gross up).[44] Since the distribution of $75 exceeds CFC1's foreign earnings for U.S. tax purposes, the excess of $34 ($75 – 41u x $1) should be treated as a reduction in the basis of CFC1's shares (§§ 301(c)(1), (2)), such that USP's CFC1 basis going forward is $66 ($100 - $34). The U.S. tax on the foreign income is $17.15 (35% x ($57.50 – $8.50 deduction for foreign taxes under §901(m)(6)). Of this amount, $16.50 ($25 foreign taxes paid - $8.50 disqualified tax amount) is available as an FTC leaving $0.65 in residual U.S. tax. The §338 election still provides tax benefits despite §901(m) limitations because it still allows disallowed foreign taxes to be deducted and excluded from the gross-up inclusion (§901(m)(6))—absent the election, the residual U.S. tax would be $10 (35% x ($100 - $25)).

[44] The §78 gross up is limited to the amount of creditable foreign tax paid, *see* §901(m)(6).

APPENDIX B

ERICKSON AND WANG (2007) DERIVATION

An acquirer should be willing to offer a higher price in a taxable asset purchase than in a taxable stock purchase to obtain the additional tax benefits from stepping-up the tax basis of the target's assets. The additional price offered by the acquirer in a taxable asset purchase is limited by the value of the tax benefits from the step-up in basis and reduced by the value of the target's tax attributes extinguished in a step-up structure. Assuming straight-line depreciation and amortization for the assets acquired, the maximum price that the acquirer should be willing to pay in a taxable asset purchase (MXP_{ast}) is:

$$MXP_{ast} = P_{stk} + \left\{\left[(MXP_{ast} - ASB) * \frac{d}{N}\right] * PV_s * t_c\right\} - (P_{stk} * r * PV_a * t_c) \quad \text{(B.1)}^{45}$$

where P_{stk} is price paid to target shareholders in a taxable stock purchase, *ASB* is the net tax basis of the target's assets pre-acquisition, *d* is the percentage of the step-up in basis attributable to depreciable or amortizable assets, *N* is the period over which the step-up will be depreciated/amortized on a straight-line basis, PV_s is the present value of an n period annuity for the step-up, t_c is the corporate tax rate, *r* is the long-term tax-exempt rate set by the government, and PV_a is the present value of an annuity for the tax attributes preserved after a taxable stock purchase.

Stated more plainly, the maximum price the acquirer is willing to pay is the linear combination of three terms: (1) the value of the shares, *plus* (2) the present value of the tax

[45] *See supra* note 25.

benefits from the asset basis step-up, *less* (3) the present value of the target's extinguished tax attributes. The additive second term is the amount by which the price exceeds the net tax basis in the assets (the step-up), multiplied by the percentage of depreciable/amortizable assets, divided by the depreciation/amortization period. This per-year benefit is then discounted back to the acquisition period and tax effected. The negative third term is the discounted and tax effected amount of the target's tax attributes available to offset post-acquisition income.[46]

Since a taxable asset purchase entails two layers of tax, at a given price, the seller's welfare is less in a taxable asset sale (SLP_{ast}) than in a taxable stock sale without a §338 election (SLP_{stk}).

$$SLP_{ast} = P_{ast} - [(P_{ast} - ASB - ATT) * t_c] - \big[[(P_{ast} - (P_{ast} - ASB - ATT) * t_c) - SKB] * t_{cg}\big], \quad \text{(B.2)}$$

$$SLP_{stk} = P_{stk} - [(P_{stk} - SKB) * t_{cg}], \quad \text{(B.3)}$$

where P_{ast} is the price paid to the target corporation for its assets in a taxable asset acquisition, *ATT* represents the target's tax attributes, t_{cg} is the target shareholder's capital gain tax rate, *SKB* is the target shareholder's stock basis, and other variables are as defined above. In Eq. (B.2), the target shareholder's welfare is determined after the target- and shareholder-level taxes, the latter being a function of the after-tax proceeds from the target's asset sale. In Eq. (B.3), the target

[46] *See supra* note 26.

shareholder only incurs the shareholder-level tax. Setting Eqs. (B.2) and (B.3) equal and simplifying, the price a seller demands to be indifferent between the transaction structures is:

$$P_{ast} = \frac{P_{stk} - ASB * t_c - ATT * t_c}{1 - t_c} \quad \text{(B.4).}$$

If Eqs. (B.1) and (B.4) are equal, Erickson and Wang (2007) show that this tradeoff could make target shareholders indifferent between a taxable asset purchase and taxable stock purchase. However, if Eq. (B.1) is less than Eq. (B.4)—likely the case when discount rates are greater than zero and tax rates are constant—the additional price offered, limited by the present value of tax benefits from the step-up, less the present value of the target's tax attributes extinguished, is not enough to meet the price demanded by the target shareholders in a taxable asset sale. They conclude that this limitation leads to many U.S. taxable acquisitions of C corporations being structured as stock deals without a §338 election rather than a taxable asset purchase.

APPENDIX C

VARIABLE DEFINITIONS

Variable	Definition	Source
Acquisition size	Total transaction value divided by acquirer total assets in *t*-1.	Compustat, S&P Capital IQ
Cash	The natural logarithm of the ratio of cash and cash equivalents to net assets (total assets minus cash) in year *t*-1. For *PRE(^)* and *PRE*Δ specifications in Table 7 it is the change from *t*-2 to *t*-1.	Compustat
Decile Price	Decile rank of total transaction value.	S&P Capital IQ
Foreign Target	Indicator equal to 1 if the target firm's country of incorporation (tnation) is not United States and 0 otherwise.	S&P Capital IQ
High-tax (Med)	Indicator equal to 1 if the corporate tax rate in the target firm's country of incorporation is greater than the median.	Fox, Krull, and Rane (2025)
Leverage	Total debt scaled by total assets in year *t*-1. For *PRE(^)* and *PRE*Δ specifications in Table 7 it is the change from *t*-2 to *t*-1.	Compustat
Log(Price)	The natural log of the total transaction value.	S&P Capital IQ
Post 901(m)	Indicator equal to 1 if the transaction is completed or unconditional after December 31, 2010, and 0 otherwise. For PRE specifications in Table 7 it is an equal to 1 for fiscal years ending after December 31, 2010.	S&P Capital IQ, Compustat
PRE($)	Earnings designated as permanently invested scaled by total assets in year *t.*	Audit Analytics, Compustat
PRE(^)	Indicator equal to 1 if PRE increased from *t*-1 to *t*, and 0 otherwise.	Audit Analytics
Δ*PRE*	Change in earnings designated as permanently invested from year *t*-1 to *t*.	Audit Analytics
Premium	Total transaction value divided by implied enterprise value.	S&P Capital IQ
ROA	Earnings before interest and taxes scaled by total assets in year *t*-1. For *PRE(^)* and *PRE*Δ specifications in Table 7 it is the change from *t*-2 to *t*-1.	Compustat
SalesGr	Sales growth from year *t*-2 to *t*-1.	Compustat
Size	The natural log of total assets in year *t*-1. For *PRE(^)* and *PRE*Δ specifications in Table 7 it is the change from *t*-2 to *t*-1.	Compustat

Target Tax Rate	Corporate tax rate in the target country jurisdiction. U.S. tax rate includes a blended rate for state tax burdens.	Fox, Krull, and Rane (2025)
TSA	Indicator equal to 1 if the transaction is the acquisition of the target's equity for cash/assets and 0 otherwise.	S&P Capital IQ
US Acq	Indicator equal to 1 if the acquirer, its immediate parent, or ultimate parent is incorporated or headquartered in the United States and 0 otherwise.	LSEG M&A, Compustat
WkCap	Net working capital (current assets – current liabilities), minus cash and cash equivalents, scaled by total assets in year *t*-1. For *PRE(^)* and *PRE*Δ specifications in Table 7 it is the change from *t*-2 to *t*-1.	Compustat
XB	Indicator equal to 1 if the target firm's country of incorporation (tnation) is not the acquirer firm's country of incorporation (anation).	S&P Capital IQ
XB TSA	Indicator equal to 1 if the transaction is a cross-border *TSA* and 0 otherwise.	S&P Capital IQ

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