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Tax Avoidance in Response to a Decline in the Funding Status of Defined Benefit Pension Plans

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Abstract

We examine the effect of the funding status of defined benefit (DB) pension plans on company tax avoidance behavior. Our results reveal that firms engage more in tax avoidance when the pension deficit, defined as pension liabilities minus pension assets scaled by total assets, increases. We find that for an average pension deficit firm one standard deviation increase in pension deficit is associated with annual tax savings of \$3.64 million. For 2014 we find that, on the aggregate level, for firms with underfunded DB pension plans a one standard deviation increase in pension deficit is associated with annual tax savings of more than 2.7 billion dollars. Our results hold after controlling for factors such as profitability, financial constraints, operating losses, and foreign income.

Keywords: *Tax avoidance, tax planning, defined benefit pension plan, pension deficit, underfunded pension plan*

JEL Classification: G32, H26, J32

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